

United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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ARTESIAN WATER COMPANY, a corporation,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the United States  
Board of Tax Appeals.

FILED

JULY 5 1941

PAUL P. O'BRIEN,



United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES:

For Taxpayer:

GEORGE A. WITTER, Esq.

For Comm'r:

E. A. TONJES, Esq.

Docket No. 100842

ARTESIAN WATER COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

1939

Dec. 12—Petition received and filed. Taxpayer notified. (Fee paid).

Dec. 12—Copy of petition served on General Counsel.

1940

Jan. 23—Answer filed by General Counsel.

Jan. 23—Request for circuit hearing Los Angeles, Calif., filed by General Counsel.

Jan. 25—Notice issued placing proceeding on Los Angeles, Calendar. Answer and request served.

Apr. 5—Motion to place on Circuit Calendar for hearing in Los Angeles, California in June, 1940, filed by taxpayer.

1940

Apr. 11—Hearing set June 3, 1940, in Los Angeles, California.

June 11—Hearing had before Mr. Black on merits. Submitted. Amended petition and answer to amend petition filed. Copies served. Petitioner's brief due July 26, 1940. Respondent's Aug. 26, 1940. Reply Sept. 10, 1940.

July 11—Transcript of hearing of June 11, 1940, filed.

July 22—Brief filed by taxpayer. 7/22/40 copy served on General Counsel.

Aug. 26—Brief filed by General Counsel.

Sept. 5—Motion for extension of 20 days to file reply brief filed by taxpayer. 9/5/40 granted.

Sept. 20—Reply brief filed by taxpayer. 9/20/40 copy served on General Counsel.

1941

Jan. 22—Findings of fact and opinion rendered, Mr. Black, Div. 15. Decision will be entered for the respondent.

Jan. 24—Decision entered, Black, Div. 15.

Apr. 16—Petition for review by United States Circuit Court of Appeals, Ninth Circuit, filed by taxpayer.

Apr. 16—Praecipe filed by taxpayer.

Apr. 17—Proof of service of petition for review filed by taxpayer.

Apr. 17—Proof of service of praecipe filed. [1\*]

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\*Page numbering appearing at foot of page of original certified Transcript of Record.

United States Board of Tax Appeals

Docket No. 100824

ARTESIAN WATER COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

**PETITION**

The above named Petitioner hereby appeals from the determination of the Respondent set forth in his deficiency letter dated September 21, 1939, symbols IT:LA FHG-90D, and as a basis of this proceeding alleges as follows:

**I.**

Petitioner is a corporation organized and existing under and by virtue of the laws of the State of California with its principal place of business at Los Angeles, California.

**II.**

The deficiency letter, copy of which is attached hereto and marked Exhibit "A", was mailed to the Petitioner on or about September 21, 1939.

**III.**

The taxes in controversy are for the calendar year 1937 and amount to the sum of \$7,380.33.

## IV.

The determination of taxes set forth in said deficiency letter is based upon the following error:

Respondent erred in imposing a surtax upon the undistributed profits of the Petitioner. [2]

## V.

The facts upon which Petitioner relies as a basis for this proceeding are as follows:

The Petitioner was placed in receivership under jurisdiction of the Superior Court of the State of California in and for Los Angeles County in the year 1935 and remained continuously in receivership until finally discharged February 8, 1939. During the entire year 1937 Petitioner was in State Receivership and insolvent.

In 1929 and 1930 the Petitioner borrowed from the Pacific Mutual Life Insurance Company of California a total amount of \$210,000.00, evidenced by four notes, all of which matured on November 12, 1934. These notes were secured by a mortgage on the lands owned by the Petitioner. The Petitioner was unable to make payment on the notes and on November 7, 1934, made application for a renewal or extension. This request was rejected by letter dated November 9, 1934, but time for the payment of the loan was thereafter advanced from quarter to quarter during the year 1935 and the early part of 1936.

In 1936 the Insurance Commissioner of the State of California made a special investigation of the

Pacific Mutual Life Insurance Company of California, as a result of which he severely criticized the loans to this Petitioner. The Commissioner appointed a Conservator for the Insurance Company. The Conservator of the Company made repeated and insistent demands upon the Petitioner, then in receivership, for payment of its loans. The Petitioner was wholly unable to meet such demands. The Petitioner, acting through [3] its Receiver, made efforts to refinance the loan or a portion thereof but without success. On or about September 1, 1936, the Receiver of the Petitioner began making monthly payments to the Conservator. During the year 1937 the Petitioner paid said Conservator the amount of interest due on said notes and approximately \$83,000.00 on principal. On December 31, 1937, the balance owing to said Conservator was \$100,250.00 on account of said notes. The Petitioner's net taxable income for 1937 was \$54,101.14. During all of the year 1937 the lands and leasehold of the Petitioner were assigned to the said insurance company as security for said loans and said leasehold represented 97% of the Petitioner's income .

Wherefore, Petitioner prays that the Board hear and determine this appeal and render judgment in accordance with the foregoing.

GEORGE G. WITTER (Sgd)

Attorney for Petitioner

453 South Spring Street

Los Angeles, California [4]

State of California,  
County of Los Angeles—ss.

Howard C. Bonsall, being duly sworn, deposes and says: That he is the President of the Artesian Water Company, the Petitioner named in the foregoing petition, that he is duly authorized to verify the same; that he has read the said petition and is familiar with the statements contained therein and that the facts stated are true as he verily believes.

HOWARD C. BONSALL (Sgd)

Subscribed and sworn to before me this 6th day of December, 1939.

[Seal] ROLAND FRIESS (Sgd)

Notary Public in and for said County and State.

My Com. expires Nov. 25, 1942. [5]

EXHIBIT "A"

Treasury Department  
Internal Revenue Service  
12th Floor  
U. S. Post Office and Court House  
Los Angeles, California

Sep. 21, 1939

Office of  
Internal Revenue  
Agent in Charge  
Los Angeles Division  
IT:LA  
FHG-90D  
Artesian Water Company,  
Consolidated Building,  
Sixth and Hill Streets,  
Los Angeles, California.

Sirs:

You are advised that the determination of your income tax liability for the taxable year 1937 discloses a deficiency of \$7,380.33 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, Los Angeles, California, for the attention of IT:LA:FC. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,  
Commissioner,

By (Signed) GEORGE D. MARTIN

Internal Revenue Agent in Charge.

Enclosures:

Statement.

Form of Waiver. [6]

FHG-MAH

**STATEMENT**

IT:LA  
FHG-90D

Artesian Water Company,  
Consolidated Building,  
Sixth and Hill Streets,  
Los Angeles, California.

Tax Liability for the Taxable Year Ended  
December 31, 1937.

Income Tax Liability—\$14,335.50

Assessed—\$6,955.17

Deficiency—\$7,380.33

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 13, 1939; to the protest dated February 7, 1939; to the statements made at the conference held on February 28, 1939; and to Bureau letters dated March 3, 1939 and May 9, 1939.

While your corporation was in receivership during the entire taxable year, such receivership was terminated and the receiver discharged on February 23, 1939; and the assessment of income tax made under the provisions of Section 274 of the Revenue Act of 1936, of which you were advised in Bureau letter dated March 3, 1939, has been abated.

A copy of this letter and statement has been mailed to your representative, Mr. George G. Witter, Citizens National Bank Building, Los Angeles, California, in accordance with the authority contained

in the power of attorney executed by you and on file with the Bureau. [7]

Net Income

Taxable year ended December 31, 1937.

Net income as disclosed by return.....\$54,101.14

No change is made in the net income as reported in the return filed for the taxable year, and the deficiency stated herein is due to the computation of the surtax on undistributed profits imposed by Section 14 of the Revenue Act of 1936, for which no computation was included in the return.

The contention made, in both the return and the protest, that the corporation was not liable in the taxable year for the surtax imposed by the said Section 14, is denied for the reason that the evidence presented fails to show that you came within the purview of the exemption granted by Section 14 (d)(2).

In computing the surtax only the amount of \$8,250.00 paid on relevant indebtedness is allowed as a credit for contracts restricting dividend payments, under the provisions of Section 26(c)(1) of the Revenue Act of 1936, for the reason that the information presented fails to substantiate that a greater credit is allowable. [8]

## COMPUTATION OF TAX

Taxable year ended December 31, 1937

## NORMAL INCOME TAX

Taxable net income.....	\$54,101.14
Less: Excess-profits tax.....	None
<hr/>	
Normal—tax net income.....	\$54,101.14
Normal tax:	
8% of \$ 2,000.00.....	\$ 160.00
11% of 13,000.00.....	1,430.00
13% of 25,000.00.....	3,250.00
15% of 14,101.14.....	2,115.17
<hr/>	
Total normal tax.....	\$6,955.17

## SURTAX ON UNDISTRIBUTED PROFITS

Taxable net income.....	\$54,101.14
Less: Normal tax.....	6,955.17
<hr/>	
Adjusted net income.....	\$47,145.97
Less: Credit for contracts restricting dividend payments.....	8,250.00
<hr/>	
Undistributed net income.....	\$38,895.97
Surtax:	
7% of \$ 5,000.00.....	\$ 350.00
12% of 4,714.60.....	565.75
17% of 9,429.20.....	1,602.96
22% of 9,429.19.....	2,074.42
27% of 10,322.98.....	2,787.20
<hr/>	
Total surtax .....	\$ 7,380.33
Normal tax .....	6,955.17
<hr/>	
Total income tax (normal tax and surtax).....	\$14,335.50

Income tax assessed (normal tax and surtax):

Original list, account No. 402482.....	\$6,955.17
Additional, page 0, line 0, Commis-	
sioner's #2 list, March 10, 1939	
(Sec. 274) .....	\$7,380.33
Less: Abatement allowed	
July 28, 1939.....	7,380.33
	0.00
Net amount assessed.....	6,955.17
Deficiency of income tax.....	\$ 7,380.33

[Endorsed]: U. S. B. T. A. Filed Dec. 12, 1939.

[9]

[Title of Board and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I and II. Admits the allegations contained in paragraphs I and II of the petition.

III. Admits that the taxes in controversy are for the calendar year 1937; denies the remainder of the allegations contained in paragraph III of the petition.

IV. Denies the allegations of error contained in paragraph IV of the petition.

V. Denies the allegations of fact contained in paragraph V of the petition.

VI. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied [10]

Wherefore, it is prayed that the determination of the Commissioner be approved.

(Signed) J. P. WENCHEL

FTH

Chief Counsel,  
Bureau of Internal Revenue

Of Counsel:

ALVA C. BAIRD,  
FRANK T. HORNER,  
E. A. TONJES,

Special Attorneys,  
Bureau of Internal Revenue.

EAT/mm 1/15/40

[Endorsed]: U. S. B. T. A. Filed Jan. 23, 1940.

[11]

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[Title of Board and Cause.]

AMENDED PETITION

The above named Petitioner hereby appeals from the determination of the Respondent set forth in his deficiency letter dated September 21, 1939, symbols IT:LA FHG-90D, and as a basis of this proceeding alleges as follows:

**I.**

Petitioner is a corporation organized and existing under and by virtue of the laws of the State of California with its principal place of business at Los Angeles, California.

**II.**

The deficiency letter, copy of which is attached hereto and marked Exhibit "A", was mailed to the Petitioner on or about September 21, 1939.

**III.**

The taxes in controversy are for the calendar year 1937 and amount to the sum of \$7,380.33.

**IV.**

The determination of taxes set forth in said deficiency letter is based upon the following error:

Respondent erred in imposing a surtax upon the undistributed profits of the Petitioner. [12]

**V.**

The facts upon which Petitioner relies as a basis for this proceeding are as follows:

The Petitioner was placed in receivership under jurisdiction of the Superior Court of the State of California in and for Los Angeles County in the year 1935 and remained continuously in receivership until finally discharged February 8, 1939. During the entire year 1937 Petitioner was in State Receivership and insolvent.

In 1929 and 1930 the Petitioner borrowed from the Pacific Mutual Life Insurance Company of

California a total amount of \$210,000.00, evidenced by four notes, all of which matured on November 12, 1934. These notes were secured by a mortgage on the lands owned by the Petitioner. The Petitioner was unable to make payment on the notes and on November 7, 1934, made application for a renewal or extension. This request was rejected by letter dated November 9, 1934, but time for the payment of the loan was thereafter advanced from quarter to quarter during the year 1935 and the early part of 1936.

In 1936 the Insurance Commissioner of the State of California made a special investigation of the Pacific Mutual Life Insurance Company of California, as a result of which he severely criticized the loans to this Petitioner. The Commissioner appointed a Conservator for the Insurance Company. The Conservator of the Company made repeated and insistent demands upon the Petitioner, then in receivership, for payment of its loans. The Petitioner was wholly unable to meet such demands. The Petitioner, acting through its Receiver, made efforts to refinance the loan or a [13] portion thereof but without success. On or about September 1, 1936, the Receiver of the Petitioner began making monthly payments to the Conservator. During the year 1937 the Petitioner paid said Conservator the amount of interest due on said notes and approximately \$83,000.00 on principal. On December 31, 1937, the balance owing to said Conservator was \$100,250.00 on account of said notes. The Petition-

er's net taxable income for 1937 was \$54,101.14. During all of the year 1937 the lands and leasehold of the Petitioner were assigned to the said insurance company as security for said loans and said leasehold represented 97% of the Petitioner's income.

On January 1, 1937, the Petitioner, then in receivership still, owed on account of notes which had matured more than two years before, the principal sum of \$183,250.00. It had an operating deficit on January 1, 1937, of \$50,571.97. On December 31, 1937, it still owed on account of said notes the principal sum of \$100,250.00 and had an earned surplus of \$34,442.50. Said deficit and earned surplus as stated, however, was determined without any deduction for depletion. If depletion were applied, there would still be a deficit at the close of the year 1937.

The following quoted sections are taken from the Civil Code of the State of California, and were in full force and effect during all the period mentioned in this petition.

“§346. Cash or Property Dividends. A corporation may declare dividends payable in cash or in property only as follows:

“(1) Out of earned surplus; or

“(2) Despite the fact that the net assets of the corporation amount to less than the stated capital, [14] out of net profits earned during the preceding accounting period which shall not be less than six months nor more than one year in duration; or

\* \* \* \* \*

“Dividends: No dividends shall be declared when there is reasonable ground for believing that thereupon the corporation’s debts and liabilities would exceed its assets or that it would be unable to meet its debts and liabilities as they mature.

\* \* \* \* \*

“Wasting Asset Corporation. A wasting asset corporation, that is a corporation engaged solely or substantially in the exploitation of mines, oil wells, gas wells, patents or other wasting assets, or organized solely or substantially to liquidate specific assets, may distribute the net income derived from the exploitation of such wasting assets or the net proceeds derived from such liquidation without making any deduction or allowance for the depletion of such assets incidental to the lapse of time, consumption, liquidation or exploitation; subject, however, to adequate provision for meeting debts and liabilities and the liquidation preferences of outstanding shares and to notice to shareholders that no deduction or allowance has been made for such depletion. (Added by Stats. 1931, p. 1803; Amended by Stats. 1933, p. 1384.)

\* \* \* \* \*

“§363. Unlawful Dividends, Purchases and Distribution. Except as provided in this title, the directors of a corporation shall not authorize or ratify the purchase by it of its shares or declare or pay dividends or authorize or ratify

the withdrawal or distribution of any part of its assets among its shareholders."

Said Petitioner was wholly unable to make adequate provision for payment of its indebtedness in the year 1937. Its net taxable income was \$54,101.14. It actually paid \$83,000.00 on its indebtedness in 1937. It still owed \$100,250.00 at the end of the year 1937, which indebtedness at that time was over three years in default and bearing interest at the rate of [15] Seven Per Cent. Had the Petitioner applied its total gross receipts to payment of said indebtedness in 1937 it still would not have made adequate provision for payment of indebtedness.

Said Petitioner was prohibited under said laws from declaring any dividends during 1937. Said laws are a part of the Petitioner's charter and constituted a contract restricting the declaration of any dividends during 1937.

To secure said notes the Petitioner had assigned in writing all rents and royalties from its lands to the owner and holder of said notes and said assignment constituted a contract restricting its declaration of dividends throughout the year 1937.

Wherefore, Petitioner prays that the Board hear and determine this appeal and render judgment in accordance with the foregoing.

GEORGE G. WITTER (Sgd)

Attorney for Petitioner

453 South Spring Street  
Los Angeles, California.

[16]

State of California,  
County of Los Angeles—ss.

Howard C. Bonsall, being duly sworn, deposes and says: That he is the President of the Artesian Water Company, the Petitioner named in the foregoing Amended Petition, that he is duly authorized to verify the same; that he has read the said Amended Petition and is familiar with the statements contained therein and that the facts stated are true as he verily believes.

HOWARD C. BONSALL (Sgd)

Subscribed and sworn to before me this 4th day of June, 1940.

[Seal] ROLAND FRIESS (Sgd)  
Notary Public in and for said County and State.

For Exhibit "A" see Exhibit "A" attached to petition.

[Endorsed]: U.S.B.T.A. Filed at hearing Jun.  
11, 1940. [17]

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[Title of Board and Cause.]

#### ANSWER TO AMENDED PETITION

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

I and II. Admits the allegations contained in paragraphs I and II of the amended petition.

III. Admits that the taxes in controversy are for the calendar year 1937; denies the remainder of the allegations contained in paragraph III of the amended petition.

IV. Denies the allegations of error contained in paragraph IV of the amended petition.

V. Denies the allegations of fact contained in paragraph V of the amended petition.

VI. Denies each and every allegation contained in the amended petition not hereinbefore specifically admitted or denied. [18]

Wherefore, it is prayed that the determination of the Commissioner be approved.

J. P. WENCHEL,  
Chief Counsel,  
Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,  
FRANK T. HORNER,  
E. A. TONJES,  
Special Attorneys,  
Bureau of Internal Revenue.

EAT/mm 6/4/40.

[Endorsed]: U.S.B.T.A. Filed Jun. 11, 1940. [19]

[Title of Board and Cause.]

Docket No. 100824. Promulgated January 22,  
1941.

1. Petitioner during the taxable year was in the hands of a receiver but was not insolvent. The receivership had not been instituted by the corporation's creditors but by a dissatisfied stockholder. Petitioner had assets which considerably exceeded its liabilities and during the taxable year had a net income of \$54,101.14 and paid to its principal creditor very substantial payments on its indebtedness. Held, that petitioner is not exempt from the undistributed profits surtax as an insolvent corporation in receivership, under the provisions of section 14 (d) (2), Revenue Act of 1936.

2. Petitioner in the beginning of the taxable year had a deficit, but with its earnings, in the taxable year that deficit was wiped out and at the end of the year it had an earned surplus. Held, that the applicable code of California, which prevented petitioner from declaring any dividend so long as it had a deficit, is not a contract restricting the payment of dividends within the meaning of section 26 (c) (1), Revenue Act of 1936. *Helvering v. Northwest Steel Rolling Mills, Inc., ..... U. S. ....*

3. Petitioner, to secure its indebtedness to an insurance company which was its principal creditor, several years prior to the taxable

year gave a mortgage on two farms which it owned, and as additional security it assigned certain oil royalties which it was to receive under the terms of an oil lease. These oil royalties were to be paid to petitioner and not to the creditor. Held, there is nothing shown in the assignments of these oil royalties as additional security which expressly restricted petitioner in the payment of dividends within the meaning of section 26 (c) (1), Revenue Act of 1936.

George G. Witter, Esq., for the petitioner.  
E. A. Tonjes, Esq., for the respondent.

The Commissioner has determined a deficiency of \$7,380.33 in petitioner's surtax liability for the year ended December 31, 1937. The Commissioner in his deficiency notice, in explanation of his determination of the deficiency, stated as follows:

No change is made in the net income as reported in the return filed for the taxable year, and the deficiency stated herein is due to the computation of the surtax on undistributed profits imposed by Section 14 of the Revenue Act of 1936, for which no computation was included in the return.

The contention made, in both the return and the protest, that the corporation was not liable in the taxable year for the surtax imposed by the said Section 14, [20] is denied for the reason that the evidence presented fails to show

that you came within the purview of the exemption granted by Section 14 (d) (2).

In computing the surtax only the amount of \$8,250.00 paid on relevant indebtedness is allowed as a credit for contracts restricting dividend payments, under the provisions of Section 26 (c) (1) of the Revenue Act of 1936, for the reason that the information presented fails to substantiate that a greater credit is allowable.

To this action of the Commissioner imposing a surtax upon the undistributed profits of petitioner for the year 1937, the petitioner has assigned error. That assignment of error has been denied by the Commissioner and this presents the only issue for our decision.

#### FINDINGS OF FACT.

The petitioner is a California corporation, with principal place of business in the city of Los Angeles in said state.

Prior to and during the taxable year the petitioner owned certain assets which are described in part only in our record. Specifically two parcels of farm lands are legally described in a mortgage dated November 12, 1929, which is in evidence. Certain other properties, namely, the Shell Oil lease, the Home Villa Tract (a subdivision), and the Asphalt Paving Co. lease are referred to by names only in the evidence. From the income producing standpoint the Shell Oil lease, which yielded

more than 90 percent of all of petitioner's income during the taxable year, was the most valuable of all of these properties.

On November 12, 1929, the petitioner refinanced a loan owing by it to the Pacific Mutual Life Insurance Co., a corporation, hereinafter called the insurance company, by delivering to the latter two promissory notes, for \$175,000 and \$35,000, respectively, due five years after date and bearing interest at the rate of 6 percent per annum. To secure payment of these notes the petitioner executed in favor of the insurance company the mortgage hereinbefore mentioned covering its two parcels of farm lands described therein. In connection with the loan of \$175,000 the petitioner assigned a lease in which the Shell Oil Co. was lessee as a further security for the payment of the note. In accordance with the terms of the agreement the Shell Oil Co. continued to pay all royalties to the petitioner. This practice was continued through the entire year 1937. There is no evidence in the record indicating that there was any contract in writing wherein the petitioner agreed not to pay any dividends during the period it was obligated under the \$175,-000 loan.

In addition to the mortgage and assignments so executed to secure payment of the said notes, a separate agreement was made respecting the \$35,000 note to the effect that the petitioner would refrain from declaring any dividends upon its capital stock

so long as said [21] note remained unpaid. The Commissioner has allowed a credit in computing petitioner's undistributed profits tax for the amount paid by petitioner on this \$35,000 note during the year 1937.

On July 16, 1935, William E. Ware was appointed receiver for the petitioner. The appointment of Ware as receiver arose out of an action by one J. Baldwin against Frederick Ringe, who was a stockholder of the petitioner. Baldwin had a judgment against Ringe in an amount approximating \$200,000, which apparently could not be satisfied. After considerable investigation Baldwin located a safe deposit box used by Ringe which contained some of the capital stock of the Artesian Water Co., the petitioner. The stock was acquired by Baldwin under a sheriff's sale and in due course application was made to have the stock thus acquired by Baldwin transferred to him on the corporate records. The corporate officers refused to transfer the stock to Baldwin, whereupon he petitioned the Superior Court for the appointment of a receiver, on the ground that the corporate officers were not functioning under the code, which action resulted in the appointment of Ware as receiver. The receivership proceeding was not brought, nor was it continued, by reason of the inability of the corporation to pay its debts. Petitioner had substantially no debts except the amounts which it owed to the Pacific Mutual Life Insurance Co. This latter company had no part in the appointment of

the receiver, nor did it at any time press for the continuance of the receivership. The following is the order entered by the court upon the appointment of the receiver:

It is hereby ordered that until further order of this Court William E. Ware, is named and appointed receiver of the Artesian Water Company, a corporation.

That the receiver has, under the control of this court, power to bring and defend actions in his own name as receiver; to take, manage, operate and keep possession of the property, both real and personal, and each and all of it; to receive rents; collect debts; to compound for and compromise the same; and, subject to order of Court, to make transfers. The receiver is authorized to take possession of all books, records, correspondence and accounts of the said Artesian Water Company.

Said receiver, subject to the Order of this court, shall have the full power and authority to operate the business of the Artesian Water Company in each and all of its departments, and in its entirety.

The receiver took over petitioner's properties on the above date and immediately began negotiations with the insurance company for an extension or renewal of the loans above described. While these negotiations were pending, a conservator was appointed for the insurance company by the State

Insurance Commissioner of California. There is nothing in the record to show that the appointment of the conservator by the insurance commissioner had anything to do with [22] the indebtedness of petitioner. After the conservator for the insurance company took charge, he disapproved said loans to petitioner on account of an interlocking relationship between the two corporations and refused any further extension of time for their payment. The receiver then attempted to refinance the loans through brokers but was unsuccessful owing to questions raised over his legal authority to pledge the intrusted assets.

In the situation, the insurance company consented to "informally" allow the petitioner until March 2, 1937, to refinance the loans, conditioned upon certain payments being made during the ensuing period. The petitioner paid \$25,000 upon the notes during the year 1936 and made additional payments during 1937 which reduced the joint balance on the notes to \$100,250. The petitioner owed no debts, other than current obligations, which were paid when due, at any time here shown, except its said debts to the insurance company, and was at all times here material a solvent corporation.

### OPINION.

Black: The petitioner in its return for the taxable year reported gross income of \$171,493.42, from which it claimed deductions amounting to \$119,-805.17, leaving a taxable net income of \$54,101.14,

upon which it paid the normal income tax for the year.

The petitioner paid no surtax upon its undistributed profits for the year but in its return claimed an exemption from that obligation. It stated its claim for exemption as follows:

Exemption from undistributed profits surtax is claimed on the following grounds: Attention is respectfully directed to Section 14 of the Revenue Act of 1936, part (d) (2) of which reads:

(d) Exempt from surtax. The following corporations shall not be subject to the surtax imposed by this Section:

(2) Domestic corporations which for any portion of the taxable year are in bankruptcy under the laws of the United States, or are insolvent and in receivership in any Court of the United States, or of any State, Territory, or the District of Columbia.

The word "insolvent" was apparently used in its dual sense by Congress. The Senate Finance Committee Report on the Revenue Bill of 1936 of June 1, 1936, on page 15, in discussing Section 14 (d) (2), said:

The Finance Committee Bill also avoids the possibility of tax avoidance by collusive receiverships by limiting the provision to cases in which the corporation is in bankruptcy under the Federal bankruptcy laws, and to cases in which it is insolvent, i. e., its lia-

bilities are in excess of its assets or it is unable to pay the claims of creditors as they mature—and in receivership in Federal or State Courts.

The taxpayer was certainly unable to pay the claims of its creditors as they matured. That is, it was unable to pay them in the usual course of business out [23] of quick assets without selling its capital assets. 32 Corpus Juris 806 states that the word "insolvency" has two meanings:

In its general and popular meaning, the term denotes the state of one whose entire property and assets, when converted into money without unreasonable haste or sacrifice, are insufficient to pay his debts: But it is frequently used in the more restricted sense to express the inability of a person to pay his debts as they become due in the ordinary course of business.

Creditors claims, referred to above, which the corporation was unable to pay at maturity, consist of balance due the Pacific Mutual Life Insurance Company on account of money borrowed on November 12, 1929, and represented by two notes, one for \$35,000 and one for \$175,000. The note for \$35,000 carried with it a specific agreement prohibiting the payment of dividends until said note was paid. During 1936 the sum of \$26,750 was paid on this note leaving a balance of \$8,250 which balance was paid

during 1937, whereupon the note and collateral agreement were cancelled.

Similarly, during 1937 payments totaling \$74,750 were made on the note for \$175,000, making a grand total of payments made of \$83,000.

The corporation owns subdivision land and oil producing property. The oil land is under lease to Shell Oil Company. The corporation secured its note to the Pacific Mutual Life Insurance Company by a mortgage on its properties, and gave as collateral security an assignment of the oil lease "together with all rents due, or to become due thereunder." The mortgagee notified Shell Oil Co. of the pledge of the lease and rents and instructed Shell Oil Co. to continue to pay the rents and royalties due under the lease to the corporation until further notice. The note and mortgage became due November 30, 1934, and is still past due. It has not been extended or renewed, and will outlaw November 30, 1938.

The corporation has never been in a position to pay off the mortgage out of current assets. From the foregoing, it is apparent, therefore, the corporation was insolvent and in receivership during the taxable year 1937, and is exempt from the surtax under Section 14.

The respondent in his audit disallowed petitioner's claim for exemption as an insolvent corporation, but, in recognition of its agreement not to

declare dividends so long as the \$35,000 note remained unpaid, allowed it a credit from the adjusted base in amount of \$8,250, under authority of section 26 (c) (1) of the Revenue Act of 1936.<sup>1</sup>

Petitioner, in its brief, states that the points which it relies upon are as follows:

1. The petitioner was in receivership and insolvent in the taxable year.
2. The California codes prohibited the declaration of dividends by the petitioner during the taxable year. [24]

We shall take these points up in their order. As to point 1, it is clear that petitioner was in receivership, but it is also equally clear that this receivership was not occasioned by any insolvency of petitioner. It was due to an altogether different cause.

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<sup>1</sup>Sec. 26. Credits of Corporations.

\* \* \* \* \*

(c) Contracts Restricting Payment of Dividends.—

(1) Prohibition on Payment of Dividends.—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

Petitioner concedes that the receivership was not instituted by its creditor, the insurance company, nor was it prolonged by any insistence on the part of the insurance company. Petitioner does contend, however, that in the taxable year 1937 it was insolvent within the meaning of the applicable statute, and that, when the two conditions exist simultaneously, namely, insolvency and receivership, then the exemption provided by section 14 (d) (2) applies. Petitioner, in support of its contention that it was insolvent during the taxable year within the meaning of the act, quotes from *Dutcher v. Wright*, 94 U. S. 553:

Insolvency, in the sense of the Bankrupt Act, means that the party whose business affairs are in question is unable to pay his debts as they become due, in the ordinary course of his daily transactions; and a creditor may be said to have reasonable cause to believe his debtor to be insolvent when such a state of facts is brought to his notice respecting the affairs and pecuniary condition of his debtor as would lead a prudent man to the conclusion that the debtor is unable to meet his obligations as they mature, in the ordinary course of his business. *Buchanan v. Smith*, 16 Wal., 308, 21 L. Ed., 286; *Toof v. Martin*, 13 Wal. 1, 40, 20 L. Ed., 481. \* \* \*

That the word "insolvent" as used in section 14 (d) (2) was intended by Congress to carry the meaning used in the above language by the Supreme

Court, petitioner contends is evidenced by Senate Finance Committee Report of June 1, 1936, on the Revenue Bill of 1936, where on page 15, in discussing section 14 (d) (2), it is said:

The Finance Committee Bill also avoids the possibility of tax avoidance by collusive Receiverships by limiting the provision to cases in which the corporation is in bankruptcy under the Federal bankruptcy laws, and to cases in which it is insolvent, i. e., its liabilities are in excess of its assets or it is unable to pay the claims of creditors as they mature—and in receivership in Federal or State Courts.

We accept as correct the contention which petitioner makes as to the meaning of the word "insolvent" as used in section 14 (d) (2). We do not think, however, that the evidence shows that petitioner was "insolvent" within the meaning of the act and the foregoing definition at any time during the taxable year. In a balance sheet attached to its income tax return for the taxable year, its total assets are listed at a value of \$1,162,789.84; its total liabilities, exclusive of capital stock and surplus, are listed at \$144,255.21. It had net income in 1937 of \$54,101.14.

While it did not finish paying all of its indebtedness to the insurance company in 1937, it paid \$83,000 of it in that year and, as has already been stated, this creditor had nothing whatever to do with [25] instituting the receivership and took no

part in prolonging it. Under these circumstances we can not hold that petitioner was an insolvent corporation in receivership during the taxable year. It was not exempt under section 14 (d) (2). On this point we sustain respondent.

As to point 2, raised in petitioner's brief, it is equally clear that the respondent must prevail. The question of whether or not state laws and/or charter provisions of a corporation create contractual relations recognizable in determining Federal income tax questions has been the subject of diverse decisions in different courts, notably in *Northwest Steel Rolling Mills, Inc. v. Commissioner*, 110 Fed. (2d) 286, where the Circuit Court of Appeals for the Ninth Circuit sustained the position herein contended for by the petitioner; and in *Crane Johnson Co. v. Commissioner*, 105 Fed. (2d) 740, wherein the Circuit Court of Appeals for the Eighth Circuit held to the opposite view. To settle this conflict in Circuit Court opinions, the Supreme Court granted certiorari in both cases (309 U. S. 692; 311 U. S. —) and rendered its decision sustaining the Eighth Circuit Court's views in *Crane Johnson Co. v. Commissioner*, — U. S. —, and reversing the Ninth Circuit Court's decision in *Helvering v. Northeast Steel Rolling Mills, Inc.*, — U. S. — (Nov. 12, 1940). Following the Supreme Court's decision in these two cases we sustain respondent as to point 2.

We have disposed of the two points raised by petitioner in its original brief. The petitioner, in its reply brief, has raised a third point which in sub-

stance is this: Petitioner had assigned prior to May 1, 1936, as additional security for the payment of its \$175,000 note due the insurance company, the oil royalties which it was to receive from the Shell Oil Co., and while this assignment did not expressly limit petitioner in the payment of dividends so long as any of the \$175,000 note remained unpaid, nevertheless there was an implied restriction on the payment of dividends imposed by the agreement, and petitioner is entitled thereby to a credit under section 26 (c) (1), *supra*.

There is nothing to show that the assignment of the Shell Co. oil royalties by petitioner to its creditor, the Pacific Mutual Insurance Co., as further security for the payment of its \$175,000 note, in any manner expressly restricted petitioner in the payment of dividends. This assignment is not in evidence and we do not know what written provisions it contained, but the witness who testified in regard to it did not say that the assignment dealt "expressly with the payment of dividends." Petitioner does not so contend in its brief. It simply contends that because petitioner had assigned these oil royalties to its creditor, as additional security for the payment of its notes, it [26] was by necessary implication prohibited from the payment of any dividends during the effective period of the assignment. We think this contention must be denied. Cf. *Belle-vue Manufacturing Co.*, 43 B. T. A. — (Dec. 6, 1940).

Petitioner does not make any claim that it is en-

titled to a credit under the provisions of section 26 (c) (2). On account, however, of the close connection between paragraphs (1) and (2) of section 26 (c) of the Revenue Act of 1936, perhaps we should say a word as to the applicability of section 26 (c) (2) to the facts of the instant case. We have considered the evidence carefully and we find no contract in evidence which would seem to fall within the provisions of section 26 (c) (2).

Our decision in G. B. R. Oil Corporation, 40 B. T. A. 738, which was under section 26 (c) (2), is not applicable to the facts in the instant case. In that case the taxpayer, to secure the loans with which to purchase certain oil leases and oil royalties, executed and delivered to the bank from which it was borrowing the money appropriate deeds of trust and also by separate instruments in writing assigned its interests in the properties to the bank in trust and authorized the bank to receive and collect all sums of money derived from the properties and to apply same on its indebtedness to the bank. Under those circumstances, we held that the taxpayer in computing its adjusted net income was entitled to a credit under section 26 (c) (2) of the amount paid on its indebtedness during the taxable year in compliance with the contract.

In the instant case, there was no requirement that the oil royalties received from the Shell Co. should be paid to petitioner's creditor, the insurance company, as there was in G. B. R. Oil Corporation, *supra*. On the contrary, the oil royalties were

to be paid to petitioner and were in fact paid to it. The insurance company had a mortgage on these oil royalty receipts, it is true, and it is undoubtedly true that a considerable portion of them was used as payments on petitioner's indebtedness to the insurance company, but it seems to us that this falls short of meeting the requirements of section 26 (e) (2). Cf. Nocona Cotton Seed Oil Co., 42 B. T. A. 1172.

For reasons above stated we think the facts in the instant case are distinguishable from those which were present in G. B. R. Oil Corporation, *supra*.

Decision will be entered for respondent. [27]

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United States Board of Tax Appeals  
Washington

Docket No. 100824

ARTESIAN WATER COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Board, as set forth in its Findings of Fact and Opinion, promulgated January 22, 1941, it is

Ordered and decided: That there is a deficiency of \$7,380.33 in surtax liability for the year 1937.

Enter:

Entered Jan. 24, 1941.

[Seal] (Signed) EUGENE BLACK  
Member [28]

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In the United States Circuit Court of Appeals  
for the Ninth Circuit

[Title of Cause.]

**PETITION FOR REVIEW**

To the Honorable the Judges of the United States  
Circuit Court of Appeals for the Ninth Cir-  
cuit:

Artesian Water Company, a California corpora-  
tion, with its principal place of business at Los  
Angeles, California, in support of its petition filed  
in pursuance of the provisions of Section 1001 of  
the Revenue Act of 1926, for the review of the deci-  
sion of the United States Board of Tax Appeals  
rendered on January 22, 1941, approving a defi-  
ciency in income and undistributed profits taxes of  
the Artesian Water Company for the year ended  
December 31, 1937, in the sum of \$7,380.33, respect-  
fully shows to this Honorable Court as follows:

## I.

## Statement of the Nature of the Controversy.

Under date of September 21, 1939, the Commissioner of Internal Revenue mailed to the petitioner a final notice of deficiency in surtax on undistributed profits for the year 1937 [29] in the amount of \$7380.33. Within 90 days from the date of said letter the petitioner filed its appeal with the United States Board of Tax Appeals. On the 11th day of June, 1940, a hearing of said appeal was had before a member of the United States Board of Tax Appeals, sitting at Los Angeles. Oral testimony was taken and recorded and documentary evidence introduced. On the 22nd day of January, 1941, the Board handed down its final decision denying the petitioner's contentions.

The petitioner filed its original income tax return for the year 1937, disclosing thereon net income for the year in the amount of \$54,101.14 and an income tax thereon of \$6,955.17, which it paid. When the Commissioner of Internal Revenue audited this return, he determined the net income reported thereon correct and the income tax shown thereon correct, but, further finding that the Company had not distributed this income to its stockholders as dividends, the Commissioner imposed a surtax on undistributed profits based on the rates found in Section 14 of the Revenue Act of 1936. The entire deficiency asserted consists of surtax on undistributed profits and not of income tax.

The taxpayer contended before the Board and now contends that it was not and is not subject to surtax for not distributing its net earnings in the year 1937 for the following reasons.

1. It was in receivership during the entire taxable year 1937 and was unable by any means within its power to pay its debts as they matured and therefore was exempt from such surtax [30] under Section 14(d)(2) of the Revenue Act of 1936.

2. The petitioner had mortgaged all of its income-producing assets to secure indebtedness which it owed and further had assigned its leases and its income to its creditors to secure such indebtedness. Such mortgage and assignment constituted a contract restricting it from the payment of dividends and therefore exempting it from surtax on undistributed profits under Section 26(c) of the Revenue Act of 1936.

3. In the year 1937, the petitioner was unable to pay its debts as they matured and was therefore prohibited under the Statutes of the State of California from the declaration of a dividend, and such statutes constituted a part of its charter and a contract restricting it from the declaration of dividends and rendering it exempt from the surtax on undistributed profits under the provisions of Section 26 of the Revenue Act of 1926.

## II.

### Designation of Court of Review.

The petitioner being aggrieved by the said decision of the Board of Tax Appeals and having at all

times had its principal place of business in the City of Los Angeles, State of California, and having filed its income tax return for the calendar year 1937 with the Collector of Internal Revenue for the Sixth District of California, desires a review of said decision by the United States Circuit Court of Appeals for the Ninth Circuit. [31]

Wherefore, your petitioner prays that this Honorable Court may review said decision and reverse and set aside the same.

ARTESIAN WATER COMPANY,  
a Corporation.

By MARVIN OSBURN,  
Assistant Secretary.  
GEORGE G. WITTER,  
Attorney for Petitioner.

[Endorsed]: U. S. B. T. A. Filed April 16, 1941.

[32]

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In the United States Circuit Court of Appeals  
for the Ninth Circuit

[Title of Cause.]

NOTICE

To the General Counsel, Bureau of Internal Revenue, Attorney for Respondent:

You are hereby notified that on the 16 day of April, 1941, a Petition for Review of the decision of the United States Board of Tax Appeals in the above-entitled cause was filed with the Clerk of the

Board, and a true copy of said Petition is herewith served upon you.

(s) GEORGE G. WITTER  
Attorney for Petitioner

Receipt of a true copy of Petition for Review so filed is acknowledged this 17th day of April, 1941.

J. P. WENCHEL,  
Chief Counsel,  
Bureau of Internal Revenue,  
Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed Apr. 17, 1941.

[33]

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Official Report of Proceedings

before the  
U. S. Board of Tax Appeals  
Docket No. 100842

ARTESIAN WATER COMPANY,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Hearing at Los Angeles, California

Date June 11, 1940

Pages 1-40

[34]

[Title of Board and Cause.]

### REPORTER'S MINUTES

Hearing at Los Angeles on the 11th day of June,  
1940, at 10:15 o'clock, A. M.

The above-entitled proceeding came on for hearing on this the 11th day of June, 1940, before the Honorable Eugene Black, Member of the United States Board of Tax Appeals, at Los Angeles, California, pursuant to notice of hearing heretofore given; whereupon, the following proceedings were had and testimony heard, to-wit:

#### APEARANCES:

George G. Witter, Esq., (453 South Spring Street, Los Angeles, California), appearing on behalf of Petitioner.

E. A. Tonjes, Esq., (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Respondent. [36]

### PROCEEDINGS

The Clerk: Docket No. 100842, Artesian Water Company.

Appearing for the petitioner, George G. Witter.

And your address, Mr. Witter?

Mr. Witter: 453 South Spring Street, Los Angeles, California.

The Clerk: Mr. E. A. Tonjes, for the respondent.

Mr. Tonjes: That is correct, Mr. Clerk.

Mr. Witter: May it please the Board, Your Honor made an order from the bench granting leave to file an amended petition.

Mr. Tonjes: Respondent of course has no objection to that, Your Honor.

Mr. Witter: At this time I would like to file an amended petition.

The Member: The amended petition will be received and filed.

Mr. Tonjes: At this time I would like to have the privilege of filing an answer to the amended petition.

The Member: The answer will be received and filed.

Does the petitioner have any statement to make with reference to the issues involved in this case?

[37]

#### Statement of Case on Behalf of Petitioner:

By Mr. Witter:

Mr. Witter: I should like to make a brief statement of the issues involved. Also, a very brief digest of the brief that is going to be offered.

The year involved here is the year 1937. The company, the Artesian Water Company, was a company that was organized in California in 1900. It was the owner of lands. In the year 1935 it was thrown into receivership and remained in receivership until 1939. So that during the entire taxable year involved here in 1937 the petitioner was put into state receivership.

Now, the tax that has been imposed by the Government is a surtax on undistributed profits, the deficiency amounting to seven thousand three hundred eighty some odd dollars.

The facts giving rise to this issue are briefly as follows: In the year 1929 the Artesian Water Company owed the Pacific Mutual Company an indebtedness that had been incurred long prior thereto, which amounted to a balance of \$175,000. A new note was given in 1929 for that \$175,000. An additional note was given in 1931 for \$35,000, making a total indebtedness of \$210,000.

Both of these notes matured in 1934. Nothing was paid on these notes between the dates they were given and [38] the date in 1934. In 1934 the company requested the insurance company to extend the period for payment and the insurance company refused.

Then the notes ran on without any payment being made thereon, and in 1935 the Artesian Water Company was put into state receivership. It wasn't put into state receivership by the Pacific Mutual Company to whom these notes were owed. Pacific Mutual Company was secured on those notes by mortgages on practically all of the assets—I will say all of the assets of value which the Artesian Water Company owned.

The principal income of the Artesian Water Company constituted royalties from an oil lease, and to secure these notes the Artesian Water Company had not only given a mortgage on all of its land of

value, and the lands comprised all its assets, but it also assigned to the insurance company all of the rents and royalties from the lease.

In the year 1937, the taxable year, the receiver was confronted with this situation: He had been able to pay on the \$210,000 indebtedness up to January 1st approximately \$25,000. So that at the beginning of the taxable year there was due on these loans approximately \$185,000.

In the middle of the year 1936 a conservator was appointed for the Pacific Mutual and very close scrutiny made of all of its accounts. These notes to the Artesian [39] Water Company came under close scrutiny and came in for very severe criticism. The conservator insisted upon a collection being made immediately. The receiver made very strenuous efforts to get extensions of time, and the best that he was able to obtain in the way of an extension was to March 3, 1937, the insurance company calling for certain payments to be made each month, and the full balance to be paid under all circumstances by March 3, 1937.

The receiver was unable to make any payment of these notes in full or to liquidate either on March 3, 1937 or at any time during 1937. The receiver did what he could in making payments out of whatever income was received and reducing the notes. The Pacific Mutual made no further extension beyond March 3, 1937, but did not bring foreclosure suit.

Eventually, the notes were paid. The receivership

continued until 1939, and then the company emerged from the state receivership.

It is the contention of the taxpayer that it is not subject to undistributed profits tax because it was in state receivership and it was insolvent in the year 1937.

It is further the contention that under the California Codes it had no right to declare any dividends and the directors would have rendered themselves liable if they had done so, and that that would constitute an express [40] contract restricting the payment of dividends.

It is also contended that the assignment of all of the rents and royalties in writing to the note-holding creditor constituted a contract restricting the payment of dividends.

It is also contended that the statutes of this state pertaining to receivership constituted a contract which prevented this company from declaring any dividend during the year 1937.

The Member: All right, Mr. Witter.

Mr. Tonjes, do you have a statement you wish to make?

Statement of Case on Behalf of Respondent:

By Mr. Tonjes:

Mr. Tonjes: Yes.

If Your Honor please, respondent's position is that not only does the statute require that a corporation in order to be exempt from the surtax in question, be exempted, that it must be in receiver-

ship and insolvent, and it is the respondent's contention that the corporation was not insolvent.

That in so far as any restriction is contained in the law of the state of California with respect to the times or the circumstances under which a corporation can make distributions of dividends, do not constitute such a [41] contract in writing as required by the statute in order to be entitled to a dividend paid credit.

The Member: Very well.

We will receive the evidence now, Mr. Witter.

Mr. Witter: I will call Mr. Ware.

#### Evidence on Behalf of Petitioner:

Thereupon, the petitioner, to maintain the averments of its petition, introduced the following proof:

The Clerk: Give your name to the reporter, please.

Mr. Ware: William E. Ware.

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MR. WILLIAM E. WARE,

called as a witness by and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Witter:

Q. Where do you live, Mr. Ware?

A. 174 Westgate Avenue, Brentwood Heights, Los Angeles.

Q. And how long have you lived in Los Angeles?

(Testimony of Mr. William E. Ware.)

A. Oh, thirty years.

Q. And what is your business?

A. Certified Public Accountant.

Q. Were you the receiver for the Artesian Water Company, this taxpayer? [42]

A. I was.

Q. How long were you receiver for that company?

A. From July 16, 1935 to February 8, 1939.

Q. And are you generally familiar with the history of that company? A. I am.

Q. Was the company organized in the state of California? A. It was.

Q. And did it always operate in the state of California? A. It did.

Q. What was the general nature of the assets of the company?

A. It consisted principally of real properties, some vacant acreage with oil leases, and some subdivision properties and vacant properties.

Q. Are you familiar with two notes that were outstanding at the time that you were appointed receiver for the Artesian Water Company?

A. Yes.

Mr. Witter: I will ask you, Mr. Clerk, to mark these documents for identification.

The Clerk: They will be marked Petitioner's Exhibits 1, 2, and 3 for identification. [43]

(The said documents so offered were marked Petitioner's Exhibits 1, 2, and 3, for identification.)

(Testimony of Mr. William E. Ware.)

By Mr. Witter:

Q. I hand you what has been marked Petitioner's Exhibit No. 3 and ask you to state what it is.

A. That is a certified copy of the order appointing the receiver, dated July 16, 1935.

Mr. Witter: I offer Petitioner's Exhibit No. 3 in evidence.

Mr. Tonjes: No objection.

The Member: Very well, it will be received as Petitioner's Exhibit No. 3.

(The said document so offered and received in evidence, was marked Petitioner's Exhibit 3, and made a part of this record.)

### PETITIONER'S EXHIBIT NO. 3

In the Superior Court of the State of California  
in and for the County of Los Angeles.

No. 390338

J. C. BALDWIN,

Plaintiff,

vs.

FREDERICK H. RINDGE, MAY K. RINDGE,  
RHODA ADAMSON, MARVIN OSBURN,  
EDWARD L. STAEBLER, A. S. COOPER,  
HELEN N. RINDGE, P. B. GOWAN, S. N.  
WEST, GEORGE F. ARNOLD, M. F. PE-  
TERSON, RINDGE COMPANY, a corpora-

(Testimony of Mr. William E. Ware.)

tion, ARTESIAN WATER COMPANY, a corporation, JOHN DOE ONE, JOHN DOE TWO, JOHN DOE THREE, JOHN DOE FOUR, JANE ROE ONE, JANE ROE TWO, JOHN DOE ONE COMPANY, a corporation, JOHN DOE TWO COMPANY, a corporation, JOHN DOE THREE COMPANY, a corporation, and JOHN DOE AND RICHARD ROE, a co-partnership,

Defendant.

#### ORDER APPOINTING A RECEIVER.

Upon reading and filing the verified complaint of the plaintiff in the above entitled action, and upon the other papers on file herein, and good cause appearing therefor,—

It Is Hereby Ordered that until further order of this Court William E. Ware, is named and appointed receiver of the Artesian Water Company, a corporation.

That the receiver has, under the control of this court, power to bring and defend actions in his own name as receiver; to take, manage, operate, and keep possession of the property, both real and personal, and each and all of it; to receive rents, collect debts; to compound for and compromise the same; and, subject to order of Court, to make transfers. The receiver is authorized to take possession of all books, records, correspond-

(Testimony of Mr. William E. Ware.)  
ence and accounts of the said Artesian Water Company.

Said receiver, subject to the Order of this court, shall have the full power and authority to operate the business of the Artesian Water Company in each and all of its departments, and in its entirety.

[82]

It Is Further Ordered that the defendants, and each and all of them, be and appear in Department 34 of the above entitled Superior Court on the 26th day of July, 1935, at 10 o'clock A. M., to show cause, if any they have, why the appointment of the Receiver herein should not be confirmed.

It Is Hereby Ordered that the plaintiff file an undertaking with sufficient sureties, in the amount of \$1,000.00, conditioned according to law, and the Court does hereby state that said bond so required has been approved by this Court, and filed.

Be It Hereby Further Ordered that the Receiver give and file a bond, on qualifying, with sufficient sureties, in the sum of \$2,000.00, conditioned according to law, and that the said Receiver take the oath required by law. The Court does hereby state that said bond has been furnished by the Receiver, has been approved by this Court, and filed, and, further, that said Receiver has now taken the said oath, as required by law, and as above provided for.

It Is Further Ordered that the said Receiver shall, within ten days after the date of this Order, file with the Court an inventory containing a com-

(Testimony of Mr. William E. Ware.)

plete and detailed list of all property of which he shall take possession by virtue of his appointment, and if he shall thereafter take possession of other property, he shall at once file a supplementary inventory thereof.

Dated: This 16th day of July, 1935.

**WILSON**

Judge of the Superior Court  
of Los Angeles County.

The foregoing instrument is a correct copy of the original on file and/or of record in this office.  
(Omitting Points and Authorities) KR

Attest July 16, 1935.

**L. E. LAMPTON,**

County Clerk and Clerk of  
the Superior Court of the  
State of California, in and  
for the County of Los An-  
geles.

By **K. RANDALL**

Deputy

[Endorsed]: Filed Jul 16 1935. L. E. Lampton,  
County Clerk, By J. E. Shaw, Deputy.

[Endorsed]: Petitioner's Exhibit No. 3. Admit-  
ted in evidence June 11, 1940. [83]

(Testimony of Mr. William E. Ware.)

By Mr. Witter:

Q. I hand you what has been marked Petitioner's Exhibit No. 1 and ask you to state what that is.

A. This is a mortgage note for \$175,000 due to the Pacific Mutual Life Insurance Company of California by the Artesian Water Company, due in five years, with interest at the rate of six per cent per annum.

Mr. Witter: I offer in evidence Petitioner's Exhibit No. 1. [44]

Mr. Tonjes: No objection.

The Member: It will be received as Petitioner's Exhibit No. 1.

(The said document so offered and received in evidence, was marked Petitioner's Exhibit 1, and made a part of this record.)

### PETITIONER'S EXHIBIT NO. 1

No. 6509

\$175,000.00

Los Angeles, California, November 12, 1929.

Five years after date, for value received Artesian Water Company, a California Corporation, promises to pay to The Pacific Mutual Life Insurance Company of California, or order, at its office in Los Angeles the sum of One Hundred Seventy-Five Thousand Dollars, with interest from date until paid, at the rate of Six (6) per cent. per annum, payable Quarterly; should the interest not be so paid, it shall become a part of the principal

(Testimony of Mr. William E. Ware.)

and thereafter bear like interest as the principal. Should default be made in the payment of any installment of principal or interest when due, then the whole sum of principal and interest shall become immediately due and payable at the option of the holder of this note. Principal and interest payable in lawful money of the United States. This note is secured by a mortgage upon real property of even date herewith.

[Seal] ARTESIAN WATER COMPANY

By M. K. RINDGE  
President

By A. S. COOPER  
Secretary

[Stamped] Paid 7-25-38 (D) Pacific Mutual Life Insurance Co. Mortgage Loan Dept.

[Cancelled 7/25/38 R. Nehl]. [76]

(Testimony of Mr. William E. Ware.)

2-11-30	Int. paid.....	\$2,280.38 to	2-12-30
5-13-30	Int. paid.....	\$2,625.00 to	5-13-30
8-12-30	Int. paid.....	\$2,625.00 to	8-12-30
11-12-30	Int. paid.....	\$2,625.00 to	11-12-30
2-16-31	Int. paid.....	\$2,625.00 to	2-12-31
5-19-31	Int. paid.....	\$2,625.00 to	5-12-31
8-12-31	Int. paid.....	\$2,625.00 to	8-12-31
11-12-31	Int. paid.....	\$2,625.00 to	11-12-31
2-13-32	Int. paid.....	\$2,625.00 to	2-12-32
5-17-32	Int. paid.....	\$2,625.00 to	5-12-32
8-16-32	Int. paid.....	\$2,625.00 to	8-12-32
11-12-32	Int. paid.....	\$2,625. to	11-12-32
2-11-33	Int. paid.....	\$2,625. to	2-12-33
5-11-33	Int. paid.....	\$2,625. to	5-12-33
8-16-33	Int. paid.....	\$2,625. to	8-12-33
11-11-33	Int. paid.....	\$2,625. to	11-12-33
2-10-34	Int. paid.....	\$2,625. to	2-12-34
5-14-34	Int. paid.....	\$2,625.00 to	5-12-34
8-10-34	Int. paid.....	\$2,625.00 to	8-12-34
11- 8-34	Int. paid.....	\$2,625.00 to	11-12-34
2-12-35	Int. paid.....	\$2,625.00 to	2-12-35
5-13-35	Int. paid.....	\$2,625.00 to	5-12-35
8-21-35	Int. paid.....	\$2,625.00 to	8-12-35
11-13-35	Int. paid.....	\$2,625.00 to	11-12-35
2-17-36	Int. paid.....	\$2,625.00 to	2-12-36
5-12-36	Int. paid.....	\$2,625. to	5-12-36
8-18-36	Int. paid.....	\$2,625. to	8-12-36
11-13-36	Int. paid.....	\$2,625. to	11-12-36
2-12-37	Int. paid.....	\$2,625. to	2-12-37
5-12-37	Int. paid.....	\$2,611.71 to	5-12-37
8-13-37	Int. paid.....	\$2,293.30 to	8-12-37
11-12-37	Int. paid.....	\$1,933. to	11-12-37
4- 1-37	Paid a/c principal \$ 2,750	Unpaid balance \$172,250	
5- 3-37	Paid a/c principal \$ 2,750	Unpaid balance \$169,500	
6- 1-37	Paid a/c principal \$ 2,750	Unpaid balance \$166,750	
6-14-37	Paid a/c principal \$20,000	Unpaid balance \$146,750	
7- 1-37	Paid a/c principal \$ 2,750	Unpaid balance \$144,000	

(Testimony of Mr. William E. Ware.)

8- 2-37	Paid a/c principal \$ 2,750	Unpaid balance \$141,250
8-23-37	Paid a/c principal \$10,000	Unpaid balance \$131,250
9- 1-37	Paid a/c principal \$ 2,750	Unpaid balance \$128,500
10- 4-37	Paid a/c principal \$ 2,750	Unpaid balance \$125,750
11- 3-37	Paid a/c principal \$ 2,750	Unpaid balance \$123,000

[77]

## PAYMENTS

Date Paid M. D. Y.	Date Due M. D. Y.	Credited on Interest	Principal	Balance Principal Unpaid
12- 1-37	A/c .....		2,750	120,250
12-16-37	A/c .....		20,000	100,250
1- 3-38	A/c .....		2,750	97,500
2- 1-38	A/c .....		2,750	94,750
2-14-38	2-12-38 .....	1,602.88		
2-23-38	A/c .....		30,000	64,750
3- 2-38	A/c .....		2,750	62,000
4- 4-38	A/c .....		2,750	59,250
4-29-38	A/c .....		25,000	34,250
5- 2-38	A/c .....		2,750	31,500
5-11-38	5-12-38 .....	918		
6- 1-38	A/c .....		2,750	28,750
6-30-38	A/c .....		2,750	26,000
7-18-38	A/c .....		11,590	14,410
7-25-38	In full .....	333.51	14,410	0

[Endorsed]: Petitioner's Exhibit One. Admitted in evidence June 11, 1940. [79]

(Testimony of Mr. William E. Ware.)

By Mr. Witter:

Q. Mr. Ware, this note for \$175,000, marked Petitioner's Exhibit 1, do you know the history of that up to the date that it was given?

A. I think so.

Q. State briefly what the history was.

A. This represents a mortgage note which was given on November 12, 1929, secured by two parcels in Los Angeles County, two parcels of real estate in Los Angeles County, described as Parcel No. 1, being three hundred thirty acres of farm land located between Culver City and Inglewood, which is unimproved; and Parcel 2 representing fifty acres of farm land on six-tenths of a mile east of Washington Street in Culver City, which is also unimproved. It is also secured by the assignment of four leases.

Q. Oil leases?

A. No, not all of them. Some of them are farming leases, and a lease to the Asphalt Paving Company which had a small portion of the land there on which they had a plant [45] located.

Q. Testifying further as to the history of the loan, does it represent refinancing of an earlier debt owed by the company?

A. It does, yes.

Q. Do you recall when the predecessor note was given that this replaced?

A. Well, it represents a series of refinancings. You are going back as far as 1934. But the prin-

(Testimony of Mr. William E. Ware.)

cipal refinancing was in 1924, on which this loan came in.

Q. Does this \$175,000 note represent the unpaid balance of former indebtedness incurred by the Artesian Water Company? A. It does.

Q. I hand you what has been marked for identification Petitioner's Exhibit 2 and ask you to state what that is.

A. This represents a note for \$35,000 dated December 18, 1931, due November 12, 1934, given by the Artesian Water Company to the Pacific Mutual Life Insurance Company of California, with interest at the rate of six per cent per annum.

Mr. Witter: I offer in evidence Petitioner's Exhibit No. 2.

Mr. Tonjes: No objection, Your Honor.

The Member: It will be received as Petitioner's [46] Exhibit No. 2.

(The said document so offered and received in evidence, was marked Petitioner's Exhibit 2, and made a part of this record.)

#### PETITIONER'S EXHIBIT NO. 2

No. 6509

\$35,000.00

Los Angeles, California, December 18, 1931.

November 12, 1934 after date, for value received Artesian Water Company, a California corporation, promises to pay to The Pacific Mutual Life Insurance Company of California, or order, at its

(Testimony of Mr. William E. Ware.)

office in Los Angeles, the sum of Thirty Five Thousand Dollars, with interest from date until paid, at the rate of Six (6) per cent. per annum, payable February 12, 1932 and Quarterly Thereafter; should the interest not be so paid, it shall become a part of the principal and thereafter bear like interest as the principal. Should default be made in the payment of any installment of principal or interest when due, then the whole sum of principal and interest shall become immediately due and payable at the option of the holder of this note. Principal and interest payable in lawful money of the United States. This note is given for an additional loan as provided by the terms of that certain mortgage dated November 12, 1929, made by undersigned to said The Pacific Mutual Life Insurance Company of California, recorded in Book 9596 of Official Records at page 14, Records of Los Angeles County, State of California, and is secured by all the terms and conditions of said mortgage.

[Seal]

ARTESIAN WATER  
COMPANY

By M. K. RINDGE,  
President.

By A. S. COOPER,  
Secretary.

Paid 3-3-37 [Stamped on face]

Cancelled 3-3-37 [80]

(Testimony of Mr. William E. Ware.)

2-13-32	Int. paid.....	\$245.00	to	2-12-32
5-17-32	Int. paid.....	\$525.	to	5-12-32
8-16-32	Int. paid.....	\$525.	to	8-12-32
11-12-32	Int. paid.....	\$525.	to	11-12-32
2-11-33	Int. paid.....	\$525.	to	2-12-33
5-11-33	Int. paid.....	\$525.	to	5-12-33
8-16-33	Int. paid.....	\$525.	to	8-12-33
11-11-33	Int. paid.....	\$525.	to	11-12-33
2-10-34	Int. paid.....	\$525.	to	2-12-34
5-14-34	Int. paid.....	\$525.	to	5-12-34
8-10-34	Int. paid.....	\$525.	to	8-12-34
11- 8-34	Int. paid.....	\$525.	to	11-12-34
2-12-35	Int. paid.....	\$525.	to	2-12-35
5-13-35	Int. paid.....	\$525.	to	5-12-35
8-21-35	Int. paid.....	\$525.	to	8-12-35
11-13-35	Int. paid.....	\$525.	to	11-12-35
2-17-36	Int. paid.....	\$525.00	to	2-12-36
5-12-36	Int. paid.....	\$525.	to	5-12-36
8-18-36	Int. paid.....	\$525.	to	8-12-36
11-13-36	Int. paid.....	\$497.	to	11-12-36
2-13-37	Int. paid.....	\$110.92	to	2-12-37

11-12-36

As of

11- 5-36	Paid a/c principal \$24,000	Unpaid balance \$11,000
12- 1-36	Paid a/c principal \$2,750	Unpaid balance \$ 8,250
1- 5-37	Paid a/c principal \$2,750	Unpaid balance \$ 5,500
2- 2-37	Paid a/c principal \$2,750	Unpaid balance \$ 2,750
3- 3-37	Paid a/c principal \$2,750	Unpaid balance \$ 0

[Endorsed]: Petitioner's Exhibit No. 2. Admitted in evidence. June 11, 1940. [81]

(Testimony of Mr. William E. Ware.)

Mr. Witter: I offer in evidence the mortgage that went to secure the two notes that have just been introduced in evidence.

Mr. Tonjes: No objection.

The Member: It will be received as Petitioner's Exhibit No. 4.

(The said document so offered and received in evidence, was marked Petitioner's Exhibit 4, and made a part of this record.)

PETITIONER'S EXHIBIT No. 4

No. 6509

MORTGAGE

Artesian Water Company

to

The Pacific Mutual Life Insurance Company  
of California

This Mortgage, Made the twelfth day of November, A. D. nineteen hundred and twenty-nine, by Artesian Water Company, a California Corporation having its principal place of business at Los Angeles, California, Mortgagor, to The Pacific Mutual Life Insurance Company of California, a corporation organized and existing under the laws of the State of California, Mortgagee.

Witnesseth: That the Mortgagor hereby mortgages to the Mortgagee the real property situate in

(Testimony of Mr. William E. Ware.)  
the County of Los Angeles, State of California, and  
described as follows, to-wit:

Parcel #1:

That part of the Rancho Cienega O'Paso de la Tijera, lying partly within and partly without the City of Los Angeles, in the County of Los Angeles, State of California, described as follows:

Beginning at the Northwest corner of said Rancho, said point being Station 6 of the Patent Survey thereof; thence South two (2) degrees West along the West line of said Rancho one hundred thirty-two and forty-four hundredths (132.44) chains; thence South eighty-eight (88) degrees East twenty-seven and eighteen hundredths (27.18) chains to the Easterly line of the four hundred forty-four (444) acre tract allotted to Rita Botiller de Aguilar by final decree of partition of said Rancho, a certified copy of which is recorded in Book 27, Page 74 of Deeds; thence North two (2) degrees East along said Easterly line one hundred sixteen and twenty-eight hundredths (116.28) chains, more or less, to the Northerly line of said Rancho; thence North fifty-seven (57) degrees West along said Northerly line twenty-four and seventy-five hundredths (24.75) chains to Station 4; thence North sixty-five (65) degrees West five (5) chains to Station 5; thence North eighty-two and one-half (82 $\frac{1}{2}$ ) degrees West seventy-three and one-half (73 $\frac{1}{2}$ ) links more or less to a point bearing South

(Testimony of Mr. William E. Ware.)

twenty-one and three-fourths ( $21\frac{3}{4}$ ) degrees East one and fifty-four hundredths (1.54) chains from the point of beginning; thence North twenty-one and three-fourths ( $21\frac{3}{4}$ ) degrees West one and fifty-four (1.54) chains to place of beginning.

Excepting therefrom that portion thereof included in the one hundred (100) foot strip of land conveyed to the Los Angeles and Independence Railroad Company by deed recorded in Book 53, Page 553 of Deeds.

Also excepting that portion thereof described as follows:

Beginning at the intersection of the Northerly line of said one hundred (100) foot strip with the Westerly line of said Rancho; thence Easterly along said Northerly line two hundred ninety-eight (298) feet; thence at right angles Northerly eighty (80) feet; thence Westerly parallel with said Northerly line one hundred (100) feet; thence at right angles Southerly forty-four (44) feet; thence at right angles Westerly one hundred ninety-eight (198) feet; thence Southerly thirty-six (36) feet, more or less, to point of beginning.

Also excepting therefrom the Northerly two hundred feet thereof.

#### Parcel Two:

That parcel of land situate in the Rancho La Ballona, County of Los Angeles, State of California, described as follows:

Beginning at a point in the Southwest line of the County Road, said point being the most Northerly

(Testimony of Mr. William E. Ware.)

corner of the eighty-six and sixty-six hundredths (86.66) acre tract allotted to Andres Machado by final decree of partition in [86] case No. 2000 of the District Court of said County; thence along the Southwesterly line of said road, South thirty-nine (39) degrees East thirteen and twenty hundredths (13.20) chains to the point of intersection of a water ditch as it existed August 8th, 1887, with the aforesaid Southwest line of said road; thence Southeasterly along the line of said road one and seventy hundredths (1.70) chains; thence South thirty-seven and one-half ( $37\frac{1}{2}$ ) degrees East sixty-seven (67) links to the line of a "wire and board fence" as recited in deed establishing the division line between the properties of C. B. Scott and Daniel M. McGarry recorded in Book 963, Page 257 of Deeds, Records of said County; thence following the line of said fence, South eighty-five (85) degrees thirty-eight (38) minutes West fifty-seven (57) links; thence South seventy-two (72) degrees four (4) minutes West two and sixty-three hundredths (2.63) chains; thence South sixty-three (63) degrees four (4) minutes West five and nine hundredths (5.09) chains; thence South thirteen (13) degrees twenty-six (26) minutes East seventy-four (74) links; thence South twenty-three (23) degrees nine (9) minutes West four and fourteen hundredths (4.14) chains; thence South sixteen (16) degrees fifty-four (54) minutes West four and nine hundredths (4.09) chains; thence South twenty-three (23) degrees

(Testimony of Mr. William E. Ware.)

thirty-eight (38) minutes West three and twelve hundredths (3.12) chains; thence South ten (10) degrees East seven and ninety-three hundredths (7.93) chains; thence South twenty-seven (27) degrees thirty-six (36) minutes West one and seventy hundredths (1.70) chains; thence South thirty-two (32) degrees fifty-nine (59) minutes West three and sixty-four hundredths (3.64) chains; thence South twenty-seven (27) degrees twenty-two (22) minutes West three and sixty-three hundredths (3.63) chains; thence South twenty-two (22) degrees forty-five (45) minutes West ninety-five (95) links, more or less, to a point which is South sixty-six (66) degrees thirty-five (35) minutes East one and twenty-hundredths (1.20) chains; from center line of Ballona Creek; thence North sixty-six (66) degrees thirty-five (35) minutes West one and twenty hundredths (1.20) chains to the center line of said Ballona Creek at the most Northerly corner of the tract of land marked "Augustin Cota 15.205 acres" on map showing part of said Rancho La Ballona recorded in Book 17, Page 77, Miscellaneous Records of said County; thence along the center line of said creek North fifteen (15) degrees East one (1) chain, more or less, to the Northeast corner of the thirty-four and ninety-hundredths (34.90) acre tract described in deed from D. M. McGarry and wife to Louis Salzeber, recorded August 1st, 1899, in Book 1301, Page 261 of Deeds; thence North fifty-five (55) degrees fifty-five (55) minutes West sixteen

(Testimony of Mr. William E. Ware.)

and forty hundredths (16.40) chains, more or less, to the Northwesterly line of said eighty-six and sixty-six hundredths (86.66) acre tract; thence along said Northwesterly line on a course of about North thirty-one and one-half (31½) degrees East thirty-eight and twenty-seven hundredths (38.27) chains, more or less, to the point of beginning. [87] including all buildings and improvements thereon or that may be hereafter erected thereon; together with all and singular the tenements, hereditaments and appurtenances, water and water rights, pipes, flumes and ditches thereunto belonging or in anywise appertaining, the reversion, remainder and remainders, rents, issues and profits thereof, for the purpose of securing:

First. The performance of the promises and obligations of this mortgage and the payment of the indebtedness evidenced by a promissory note (and any renewal or renewals thereof) in words and figures as follows:

\$175,000.00

Los Angeles, California, November 12, 1929

Five years after date, for value received Artesian Water Company, a California Corporation, promises to pay to The Pacific Mutual Life Insurance Company of California, or order, at its office in Los Angeles, the sum of one hundred seventy-five thousand Dollars, with interest from date until paid, at the rate of six (6) per cent. per annum, payable

(Testimony of Mr. William E. Ware.)

quarterly, should the interest not be so paid, it shall become a part of the principal and thereafter bear like interest as the principal. Should default be made in the payment of any installment of principal or interest when due, then the whole sum of principal and interest shall become immediately due and payable at the option of the holder of this note. Principal and interest payable in lawful money of the United States. This note is secured by a mortgage upon real property of even date herewith.

[Corporate      ARTESIAN WATER COMPANY

Seal] By M. K. RINDGE

President

By A. S. COOPER

Secretary

Second: The payment of such additional sums, with interest, as may hereafter be loaned by said mortgagee to said mortgagor or assigns, whether evidenced by promissory note or otherwise.

Third. The payment of attorney's fees in a reasonable sum to be fixed by the Court in any action brought to foreclose this mortgage, or in any action, suit or proceeding affecting the rights of the mortgagee herein, whether brought by or against the owner of said real property, involving either the title thereto, the lien of this mortgage thereon, the validity or priority of such lien, or any right of the mortgagee hereunder, whether such action, suit or

(Testimony of Mr. William E. Ware.)

proceeding progress to judgment or not; also the payment of all costs and expenses of such suit and also such sums as said mortgagee may pay for obtaining a policy of title insurance and for searching the title to the mortgaged property subsequent to the date of the recording of this mortgage or for surveying said property; also, whenever it becomes necessary for said mortgagee, in its judgment, to make any appearance in court in connection with the property herein mortgaged the payment of all court costs, and such attorney's fees as shall be paid, or agreed to be paid, by said mortgagee; all of which said sums, including said attorney's fees, are hereby declared a lien upon said property and are secured hereby.

Fourth. The payment of all sums expended or advanced by the mortgagee for taxes, assessments, encumbrances, adverse claims, fire, cyclone or tornado insurance, inspection, repair, cultivation, irrigation, protection, fertilization, fumigation or any other expenditure in connection with the care, preservation or maintenance of said property, or for any other purpose provided for by the terms of this mortgage.

The mortgagor agrees with said mortgagee to pay, as soon as due, all taxes, assessments, liens and encumbrances, which may be, or appear to be, liens upon said property or any part thereof, while the indebtedness, or any part thereof hereby secured, remains unpaid, including taxes levied or assessed

(Testimony of Mr. William E. Ware.)

upon this mortgage or upon the debt secured hereby, and hereby waives all right to treat the payment of such taxes or assessment as a payment on the debt secured hereby or as being to any extent a discharge thereof. [88]

And the mortgagor agrees to keep the buildings now erected or which may hereafter be erected on said premises, insured against loss by fire in an amount equal to the principal sum of said promissory note (or less if satisfactory to the mortgagee) in such companies as may be satisfactory to the mortgagee, the policies for such insurance shall be made payable, in case of loss, to said mortgagee, and shall be delivered to and held by it as further security; and that in default thereof, said mortgagee may procure such insurance, not exceeding the amount aforesaid, to be effected either upon its interest as mortgagee or upon the interest of the owner of the mortgaged premises, and in its name, loss, if any, being made payable to the said mortgagee, and may pay and expend for premiums for such insurance such sums of money as it may deem to be necessary; and the mortgagor further agrees promptly to pay and settle, or cause to be removed by suit or otherwise, all adverse claims against said property.

In case said taxes, assessments or encumbrances so agreed to be paid by the mortgagor be not so paid, or said buildings so insured and said policies so made payable, in case of loss, to said mortgagee,

(Testimony of Mr. William E. Ware.)

or said adverse claim so paid, settled or removed, then the mortgagee, being hereby made the sole judge of the legality thereof, may, without notice to the mortgagor, pay such taxes, assessments or encumbrances, obtain such policies of insurance, not exceeding the amount aforesaid, to be effected either upon its interest as mortgagee or upon the interest of the owner of the mortgaged premises, and in its name, loss, if any, being made payable to the said mortgagee, and pay or settle any or all such adverse claims, or cause the same to be removed by suit or otherwise.

The mortgagor agrees to keep said property in good condition and repair and to permit no waste thereof, and should said property, or any part thereof, require any inspection, repair, cultivation, irrigation, fertilization, fumigation, or protection, other than that provided by the mortgagor, then the mortgagee, being hereby made the sole judge of the necessity therefor, and without notice to the mortgagor may enter, or cause entry to be made, upon said property, and inspect, repair, cultivate, irrigate, fertilize, fumigate, or protect said property as it may deem necessary. All sums expended by the mortgagee in doing any of the things above authorized are secured hereby and shall be paid to the mortgagee by the mortgagor in said gold coin, on demand, together with interest from the date of payment, at the same rate of interest and in the same manner as is provided to be paid in the note hereinbefore set out.

(Testimony of Mr. William E. Ware.)

In the event of a loss under said policies of fire insurance, the amount collected thereon shall be credited first to the interest due, if any, upon said indebtedness, and the remainder, if any, upon the principal sum; and interest shall thereupon cease on the amount so credited on said principal sum.

The mortgagor hereby agrees, during the life of this mortgage, that, if application be made to have the premises described herein registered under the "Land Title Law," effective December 19, 1914, or any amendment thereof, or any other law governing the registration of titles to land, the mortgagor will at once repay all costs, expenses and attorney's fees incurred and deemed by the mortgagee to be necessary for the protection of its interests in connection with such applications; and all moneys advanced by the mortgagee for any such purposes, with interest at same rate as provided in the note or notes secured hereby, are hereby declared a lien upon said property. and are secured hereby. The mortgagor further agrees that, in case of such registration, said mortgagor will cause a certified copy of the certificate so issued, by virtue of such proceedings, to be delivered to the mortgagee as soon as issued.

The mortgagor promises to pay said note according to the terms and conditions thereof; and in case of default in the payment of same, or of any installment of interest thereon when due, or if default be made in the payment of any other of the

(Testimony of Mr. William E. Ware.)

moneys herein agreed to be paid, or in the performance of any of the covenants or agreements herein contained on the part of the mortgagor, the whole sum of money then secured by this mortgage shall become immediately due and payable at the option of the holder of said note, and this mortgage may thereupon, or at any time during such default, be foreclosed, and the filing of the complaint in foreclosure shall be conclusive notice of the exercise of such option by the mortgagee.

The plaintiff in such suit of foreclosure shall be entitled, without notice, to the appointment of a receiver, to collect and receive the rents, issues and profits of the mortgaged premises, and to exercise such other powers as the Court shall confer.

It is also agreed that should this mortgage be foreclosed, then in the decree of foreclosure entered in such action, the property described therein may be ordered sold en masse—or as one lot or parcel, at the option of the mortgagee.

And also, that the mortgagee may at any time, without notice, release portions of said mortgaged premises from the lien of this mortgage, without affecting the personal liability of any person for the payment of the said indebtedness or the lien of this mortgage upon the remainder of the mortgaged premises for the full amount of said indebtedness then remaining unpaid.

The mortgagor hereby mortgages the property hereinbefore described, to secure the performance

(Testimony of Mr. William E. Ware.)  
of every promise and agreement herein contained,  
direct or conditional, and to secure the repayment  
to the mortgagee of all sums paid, laid out or ex-  
pended by the said mortgagee under the terms of  
this mortgage, and also to secure the attorney's fees  
and costs provided for by this mortgage in case of  
a foreclosure thereof.

Every covenant, stipulation and agreement herein  
contained shall bind and inure to the benefit of said  
parties, their successors, heirs, executors, adminis-  
trators or assigns.

Witness the corporate name and seal of the Mort-  
gagor the day and year first above written, by its  
President and Secretary thereunto authorized.

ARTESIAN WATER COMPANY [Seal]

By M. K. RINDGE [Seal]

President

By A. S. COOPER [Seal]

Secretary

Signed and Sealed in Presence of

.....  
.....  
[Cancelled 7-25-38 R.N.D.] [89]

15

ORDER NO.

NO. 6509

When recorded please mail to The  
Pacific Mutual Life Insurance Com-  
pany of California, Los Angeles, Cal.

**COMPARED**

Read by **NELSON**  
Document **HURST**

(C. S. C.) A. G. QUINN OF  
THE LEAD TRUST CO.

ON 23 1929 at 11:00 A.M.

ACK 252644 /4

Initial  
J. H. R.

document In Los Angeles County, Cal.

Recd. 43 Petitioner's Exhibit 4

**Mortgage**

ARTESIAN WATER COMPANY

TO

The Pacific Mutual Life  
Insurance Company  
of California

STATE OF California  
COUNTY OF Los Angeles

On this 22 of November 1929 in the year of our Lord, one thousand nine hundred and Twenty-nine before me, Sigma K. Konsko, a Notary Public in and for said County of Los Angeles residing therein, duly commissioned and sworn, personally appeared M. K. Rindge, known to me to be the President, and A. S. Cooper known to me to be the Secretary of

Artesian Water Company the corporation described in and that executed the within instrument, and known by me to be the persons who executed the within instrument on behalf of the corporation therein named, and acknowledged to me that such corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Official Seal, the day and year in this certificate first above written.

Sigma K. Konsko  
Notary Public in and for the County of Los Angeles State of California  
(CORPORATION) My commission will expire 7-15-31

STATE OF \_\_\_\_\_  
COUNTY OF \_\_\_\_\_  
On this \_\_\_\_\_ day of \_\_\_\_\_ in the year of our Lord, one thousand nine hundred and \_\_\_\_\_, a Notary Public in and for said County of \_\_\_\_\_ residing therein, duly commissioned and sworn, personally appeared \_\_\_\_\_

known to me to be the person whose name \_\_\_\_\_ subscribed to the within instrument, and \_\_\_\_\_ acknowledge to me that he executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my Official Seal, the day and year in this certificate first above written.

U. S. BOARD OF TAX APPEALS
DIV. 15 DOCKET NO. 824
ADMITTED TO EVIDENCE
JUN 11 1940
PETITIONER'S EXHIBIT 4
RESPONDENT'S

Notary Public in and for the County of \_\_\_\_\_ State of \_\_\_\_\_



(Testimony of Mr. William E. Ware.)

By Mr. Witter:

Q. Now, did the mortgage that was given to secure these notes comprise substantially all of the properties of value of the Artesian Water Company, or otherwise?

A. I believe the property known as the Home Villa property was not included, which is a subdivision property. But it represents substantially the major portion of the assets of the company, yes.

Q. Does the mortgage include all of the income-producing properties of the company with respect to the year 1937, the taxable year? A. Yes.

[47]

Q. Now, these notes matured on November 12, 1934. Were they paid on that date, Mr. Ware?

A. They were not.

Q. And on what date were you appointed receiver? A. July 16, 1935.

Q. Had any payment been made upon these notes at the time you were appointed receiver?

A. No.

Q. What steps did you take, if any, to effect any payment upon these notes as receiver?

A. During the year 1936 I attempted to secure an extension of time on these notes and submitted a proposal to Mr. Green, who was then the head of the Mortgage Loan Department of the Pacific Mutual, proposing the payment of I believe it was \$20,000 on the then indebtedness, and amortize it at the rate of \$2750 a month, plus interest.

(Testimony of Mr. William E. Ware.)

Negotiations continued for some little time to take the matter up with the Board, but in the interim, while these negotiations were going on the conservator was appointed for the Pacific Mutual Life Insurance Company. This loan was severely criticised by the conservator because of certain interlocking interests. Mr. George Cochran, who was then the president of the Pacific Mutual Life Insurance Company and Mr. Samuel Ringe, who was a member of the Board of Directors of the Pacific Mutual [48] Life Insurance Company, Mr. Lee Phillips, and Mr. Stanley McLung were all interested in the Artesian Water Company as stockholders. The conservator felt that inasmuch as there was this interlocking interest that the loan should be paid immediately, and so called the loan.

I then tried to secure a further extension of time in order to attempt to refinance, if possible. The results of these discussions were that the Pacific Mutual, the conservator for the Pacific Mutual Life Insurance Company, stated that they would give me until March of 1937 to refinance the loan, at which time if I was unsuccessful they would expect full payment.

I attempted to approach various brokers and banks for a refinancing but was met with the objection that the company being in receivership they were afraid that proper title could not be passed and that who would be available to sign the mortgage loan or create the indebtedness.

(Testimony of Mr. William E. Ware.)

In the meantime, I had been negotiating with the Shell Oil Company, who were the owners of the lease, in an effort to get them to further exploit the—

Q. Pardon me. I will introduce the correspondence you had with respect to extending the time for payment.

The Clerk: This document will be marked for identification Petitioner's Exhibit No. 5. And this will be marked Petitioner's Exhibit No. 6. [49]

(The said documents so offered were marked Petitioner's Exhibits 5 and 6 for identification.)

By Mr. Witter:

Q. Mr. Ware, I show you what has been marked for identification Petitioner's Exhibit No. 5, and I will ask you to state what it is.

A. This represents a copy of a letter written by myself as receiver to the Pacific Mutual Life Insurance Company under date of July 17, 1936 in which the matter of the unpaid principal balance of \$175,000 and \$35,000 respectively were discussed.

Mr. Witter: Your Honor doesn't care to have these letters read?

The Member: If they are introduced as exhibits it won't be necessary.

Mr. Witter: I will offer in evidence then Petitioner's Exhibit No. 5.

Mr. Tonjes: No objection.

(Testimony of Mr. William E. Ware.)

The Member: It will be received as Petitioner's Exhibit No. 5.

(The document so offered and received in evidence, was marked Petitioner's Exhibit 5, and made a part of this record.) [50]

PETITIONER'S EXHIBIT No. 5

650 South Grand Avenue

July 17, 1936

Pacific Mutual Life Insurance Company

523 West Sixth Street

Los Angeles, California

Attention—Mr. Green:

In re: Artesian Water Company

Gentlemen:

You will recall that a short time ago you requested that I discuss with you the matter of the loans heretofore made by you to the Artesian Water Company, upon which there remain unpaid principal balances of \$175,000 and \$35,000 respectively. Such loans are now in default as to principal and you have suggested that some arrangement be made to correct such defaults.

I have considered the matter in detail with a view to ascertaining what course the company can adopt to satisfy your requirements. You understand, of course, that as receiver for the company I have no power to make any commitments on its behalf, but must submit any tentative arrangements which we may make to the superior court, and that

(Testimony of Mr. William E. Ware.)

I desire to secure the consent of the board of directors of the company to any proposed settlement. I am inclined to believe, however, that I might be able to obtain the approval of the board of directors and the court of the payment of \$10,000 for application upon the principal of one or the other obligation and a new plan contemplating the payment of the balance of \$200,000 in five years with interest at the rate of five per cent per annum, payable quarterly. Since the company desires to liquidate its indebtedness at the earliest possible moment, such plan should make provision for the payment of any multiple of \$1,000 upon any quarterly interest date without penalty.

I further believe that, under present conditions, the company could pay about \$6,000 quarterly on account of principal and in the absence of unforeseen events should continue so to do.

In the event the above suggestions are not satisfactory to you, I would be happy to have the benefit of your ideas in the matter. Will you kindly communicate with me at your convenience.

Very truly yours,

WILLIAM E. WARE

Receiver—Artesian Water Company

WEW:M

C.C. to—

Mr. Marvin Osburn

Mr. Sam Rindge

Mr. William Larrabee

[Endorsed]: Petitioner's Exhibit No. 5. Admitted in evidence June 11, 1940. [91]

(Testimony of Mr. William E. Ware.)

By Mr. Witter:

Q. I show you what has been marked for identification Petitioner's Exhibit No. 6 and ask you if that is the reply of the Pacific Mutual Company to the letter marked Petitioner's Exhibit No. 5 which you yourself wrote.

A. This is a reply to my letter. But there were some discussions in the interim between the dates of this letter and this letter, which were more or less informal discussions with the Pacific Mutual Life Insurance Company.

Mr. Witter: I offer in evidence Petitioner's Exhibit No. 6.

Mr. Tonjes: No objection.

The Member: It will be received as Petitioner's Exhibit No. 6.

(The said document so offered and received in evidence, was marked Petitioner's Exhibit 6, and made a part of this record.)

(Testimony of Mr. William E. Ware.)

PETITIONER'S EXHIBIT No. 6

Pacific Mutual Life Insurance Company

Los Angeles, California

September 14, 1936

6509—Artesian Water Company

Artesian Water Company

650 South Grand Avenue

Los Angeles, California

Attention: William E. Ware, Receiver

Gentlemen:

Please be referred to the above numbered loan standing at an unpaid principal balance of \$210,000, which has been running past due since November 12, 1934, and which is secured by mortgage recorded in Book 9596, page 14, of Official Records, Los Angeles County, California.

Subject to our being able to obtain court authority to so do, we shall extend informally the time for payment of this obligation until March 2, 1937, provided—

(1) That you pay us within fifteen days from this date the sum of \$18,500 in cash, and \$3,500 on the first day of each month during said extension period commencing October 1st next, said sums as received to be applied toward liquidation of the principal of this obligation; and

(2) That interest is to be at the rate of six (6) per cent. per annum from August 12, 1936,

(Testimony of Mr. William E. Ware.)

payable quarterly, and the extension is to be subject otherwise to compliance with all terms of the original note and mortgage.

We are instructed to inform you that no further extensions of time for payment of this loan will be granted after March 2, 1937, and you will kindly make arrangements to retire this obligation not later than said date.

Very truly yours,

PACIFIC MUTUAL LIFE INSURANCE COMPANY

By JOHN B. COOLEY,

Manager Mortgage Loan Department.

JBC/D

[Endorsed]: Petitioner's Exhibit No. 6. Admitted in evidence June 11, 1940. [92]

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By Mr. Witter:

Q. Going back just a moment.

When these notes matured in 1934, Mr. Ware, if you know, was there a request for an extension of time made upon Pacific Mutual Company, and was that request refused?

A. I was not present. I don't know of my own knowledge that that was done except from subsequent correspondence and reference to notations I found in the file, [51] that was the case.

Q. In Petitioner's Exhibit 6, which is the response to your letter to the Pacific Mutual Company

(Testimony of Mr. William E. Ware.)

requesting extension of time, they give you until March 3, 1937 to make payment in full. Were you able to make payment in full on that date?

A. I was not.

Q. Did you make strenuous efforts to meet their terms laid down in that letter? A. I did.

Q. And were you wholly unable to meet the terms that they laid down in that letter?

A. I was.

Q. Now, the total indebtedness of these notes in principal amount at the time you became receiver was \$210,000, is that correct?

A. That is correct.

Q. In the year 1936, how much were you able to pay off on that principal?

A. Approximately \$25,000.

Q. So that on January 1, 1937 there was approximately \$185,000 still due on the principal indebtedness? A. That is correct.

Q. And during the year 1937 how much were you able to reduce this \$185,000 still owing? [52]

A. May I see the company's tax returns?

(The document referred to was passed to the witness.)

The Witness: It was reduced to a balance of \$100,250.

By Mr. Witter:

Q. What did the income of the company consist of?

(Testimony of Mr. William E. Ware.)

A. Approximately ninety per cent of it was from the royalties of the oil lease.

Q. Did at least ninety-seven per cent consist of oil royalties?

A. I didn't figure the percentage, but it could be.

Q. Is it true that substantially all of the income consisted of oil royalties? A. That is true.

Q. I will ask you whether or not the total oil royalties from any oil leases that the company had had been assigned to the Pacific Mutual Company?

A. They had.

Q. And had the Pacific Mutual Company merely permitted the Artesian Water Company to collect the royalties during such time as it saw fit to do so under that assignment?

A. That is correct.

Q. Mr. Ware, what was the condition of the Artesian Water Company at the beginning of the taxable year so far as [53] undivided profits or an operating deficit were concerned?

Mr. Tonjes: That is objected to, Your Honor, as calling for a conclusion and not the best evidence.

The Member: Well, I would think of course that the best evidence would be the books of the corporation. Did they have a balance sheet at that time?

Mr. Witter: Well, if Your Honor please, he was in the position of a taxpayer himself. He is an auditor. Could not he know of his own knowledge that a deficit or an undivided surplus existed on that date?

(Testimony of Mr. William E. Ware.)

The Member: Well, that is probably true, yet I should think that it would be a little risky to have a witness testify from memory as to just what that is. It seems to me that the best evidence would be the balance sheet of the company. Isn't that available?

Mr. Witter: It is on the income tax return. He possibly has it among his papers.

Do you have it, Mr. Ware?

The Witness: I don't have it in 1936. It is on the tax return.

The Member: If it is on the tax return he can read it as shown by the tax return.

By Mr. Witter:

Q. To refresh your recollection then, I will show you the balance sheet that accompanied the 1937 return filed by [54] the company and ask you whether or not there was a deficit at the beginning of the taxable year 1937, and if so how much?

A. There was a deficit of \$50,571.90.

The Member: That is as shown by the balance sheet attached to the 1937 income tax return as filed and examined by the department.

By Mr. Witter:

Q. And at the end of the taxable year that deficit had been reduced? A. It had.

Q. And what was the condition?

A. There was an undistributed profit of \$34,442.50.

The Member: Instead of a deficit?

(Testimony of Mr. William E. Ware.)

The Witness: Instead of a deficit. At the close of the year.

By Mr. Witter:

Q. While you were receiver for the company, did you have to obtain an order of the Court for any transaction of any consequence that took place?

A. Yes.

Q. Whenever you made a payment upon one of these notes, for instance, did you have to obtain an order of the Court? A. I did. [55]

Q. Were you wholly under the supervision of the Court in everything that you did?

A. I was.

Q. Did you take any action that wasn't supported either specifically or generally by an order of the Court? A. I did not.

Mr. Witter: I will ask that this be marked for identification, Mr. Clerk.

The Clerk: It will be marked Petitioner's Exhibit 7 for identification.

(The said document so offered, was marked Petitioner's Exhibit 7, for identification.)

By Mr. Witter:

Q. I hand you what has been marked for identification Petitioner's Exhibit 7 and ask you if that is a copy of an order that you obtained from the Court for making a payment upon the notes owned by the Pacific Mutual Company. A. It is.

Q. And is that a representative order such as

(Testimony of Mr. William E. Ware.)  
you obtained each time you made any payment  
upon these notes? A. It is.

Mr. Witter: I offer in evidence Petitioner's  
Exhibit No. 7.

Mr. Tonjes: No objection. [56]

The Member: It will be received in evidence as  
Petitioner's Exhibit No. 7.

(The said document so offered and received  
in evidence, was marked Petitioner's Exhibit  
7, and made a part of this record.)

#### PETITIONER'S EXHIBIT NO. 7

In the Superior Court of the State of California  
in and for the County of Los Angeles

No. 390338

J. C. BALDWIN,

Plaintiff,

vs.

FREDERICK H. RINDGE, et al.,

Defendants.

#### ORDER AUTHORIZING RECEIVER TO MAKE PAYMENT ON PRINCIPAL OF NOTE SE- CURED BY MORTGAGE AND ASSIGN- MENT OF LEASES.

The Petition of Receiver for Instructions and  
Authority to Make Payment on Principal of Note  
Secured by Mortgage and Assignment of Leases,  
dated February 18, 1938, filed by the receiver here-

(Testimony of Mr. William E. Ware.)  
in, coming on regularly for hearing on February 23, 1938, in Department 34 of the above entitled court, and it appearing that due and legal notice of the time and place of the hearing of said petition has been given to all the parties interested herein, and no person appearing to oppose the same, and evidence having been introduced in support of said petition,

It Is Hereby Ordered that said petition be granted, and that William E. Ware, as receiver for the Artesian Water Company, a corporation, is instructed and authorized to make payment, at this time, of Thirty Thousand Dollars (\$30,000.00), on account of the principal of the indebtedness described in his petition, to Pacific Mutual Life Insurance Company, a corporation; said payment to be in excess of the monthly payments of Twenty-seven Hundred Fifty Dollars (\$2,750.00) being made by him, as described in said petition.

Dated: February 23, 1938.

WILSON

Judge

[Endorsed]: Petitioner's Exhibit No. 7. Admitted in evidence June 11, 1940. [93]

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Mr. Witter: Mr. Clerk, will you mark this document for identification?

The Clerk: It will be marked for identification as Petitioner's Exhibit No. 8.

(Testimony of Mr. William E. Ware.)

(The said document so offered was marked Petitioner's Exhibit 8, for identification.)

By Mr. Witter:

Q. I hand you what is marked for identification Petitioner's Exhibit No. 8 and ask you if that is a true copy of the by-laws of the Artesian Water Company.

A. It appears to be the copy of the by-laws as I saw them.

Mr. Tonjes: Do you know, Mr. Ware?

The Witness: I haven't compared it.

Mr. Witter: I didn't compare it with the original. It was given to me by the taxpayer company as a true copy of the by-laws of the corporation. I don't desire to introduce it in evidence. I merely desire to read into the record one provision which states the powers of a director [57] so far as declaring dividends is concerned.

Mr. Tonjes: I don't like to object to the competency of the document, Your Honor, but I will object to the offer.

The Member: Go ahead and make your offer.

By Mr. Witter:

Q. Mr. Ware, you have seen the original by-laws of the company? A. I have.

Q. And you are familiar with them and their contents? A. I have read them, yes.

Q. Well, I will ask you to read Petitioner's Exhibit 8 and state whether or not that is a true copy.

A. This appears to be a copy of the by-laws.

(Testimony of Mr. William E. Ware.)

Q. Mr. Ware, calling your particular attention to the second paragraph in Article 5 of the by-laws, I will ask you if you recall that that is a true copy of the provision.

A. I would say it was, yes, because I have read that several times in connection with this matter.

Q. That purports to state the powers of the directors so far as declaring dividends is concerned? A. Yes.

Q. And this is a correct copy of what appears in the original so far as that power is concerned?

A. Yes. [58]

Mr. Witter: If Your Honor please, I do not desire to introduce this entire document because there is only one sentence here that has any bearing on the case.

I would like to read that into the record.

Mr. Tonjes: That is objected to, Your Honor, on the ground that it is incompetent. I will waive the objection with respect to competency. It is immaterial. That the by-laws of a corporation have never been held to be a contract which would either restrict or not restrict the payment of dividends by a corporation in so far as it applies to a contract under the provisions of the Revenue Act.

The Member: I will overrule the objection.

Mr. Witter: Article 5 of Petitioner's Exhibit 8, which purports to be a true copy of the by-laws of the Artesian Water Company, reads as follows: "Duties of Directors. It shall be the duty of di-

(Testimony of Mr. William E. Ware.)

rectors (second) to declare dividends out of the surplus profits when such profits shall in the opinion of the directors warrant the same.'

If Your Honor please, from a recent case it appeared that the Board of Tax Appeals did not take judicial notice of the code provisions of a state.

The Member: That is news to me.

Mr. Witter: It was news to me. [59]

Because of what I inferred from that recent decision, I came prepared to prove the laws of this state with respect to certain matters in this case. But if the Board takes judicial notice of those statutes then that proof isn't necessary.

The Member: We always have.

I am not aware of any decision of the Board that holds it is necessary to introduce into evidence the statute of the state or of the United States. Of course when it comes to a foreign law that has to be proved. But I think you surely must be mistaken as to any Board case.

Mr. Witter: It wasn't a Board decision, Your Honor. I am sorry I don't recall exactly which one it was. But it was on appeal.

The Member: I certainly have always taken judicial notice of the code of the state.

Mr. Tonjes: If Your Honor please, to clarify things, I will be willing to stipulate the Board might take judicial notice of all of the states' statutes.

(Testimony of Mr. William E. Ware.)

The Member: Yes.

That will be stipulated although I think it is unnecessary. However, you may note it in the record.

Mr. Witter: If Your Honor will bear with me for just a moment, I think I will be through. [60]

By Mr. Witter:

Q. Mr. Ware, you have stated the operating deficit that existed at the beginning of the year and the amount of undivided profits at the end of the year. I will ask you whether or not in arriving at those amounts that you have stated any deduction was taken for depletion.

Mr. Tonjes: That is objected to as being immaterial, Your Honor.

The Member: Well, I will overrule the objection. I am not prepared to say it would be immaterial at this time.

The Witness: There was not.

By Mr. Witter:

Q. Virtually all of the income that reduced the deficit was income derived from oil royalties?

A. Yes.

Q. And yet no depletion deduction was taken?

A. In the surplus account.

Q. I will ask you if you are able to say, in your opinion, as an auditor and as a receiver for the company in the taxable year, if the proper deduction had been taken for depreciation would

(Testimony of Mr. William E. Ware.)  
there have been any undivided profits balance at  
the end of the taxable year?

A. May I see the return?

(The document referred to was passed to  
the witness.) [61]

The Witness: There would have been no sur-  
plus without depletion. I say there would have  
been no depletion surplus if depletion had not  
been credited back to surplus.

Mr. Tonjes: I ask that the answer be stricken  
and the witness re-answer the question.

The Member: If he can give the gross income  
from oil royalties, why then it would be a mathe-  
matical calculation I suppose to figure what the  
depletion would be, the percentage depletion was.

The Witness: In order to answer that question,  
the tax return for the year shows an undivided  
profit at the end of the year of \$34,442.50. If that  
was reduced by the depletion of \$44,863.38 there  
would be a deficit of approximately \$10,400.

The Member: That is a better way to state it.  
That gives the figures.

By Mr. Witter:

Q. Suppose the depletion had been figured on a  
cost-depletion basis, are you able to state whether  
there would have been undivided profits at the end  
of the year? A. I wouldn't.

Q. Would the undivided profits at the end of  
the year then have been materially reduced?

(Testimony of Mr. William E. Ware.)

A. They would. [62]

Q. They would if depletion had been taken on a cost basis? A. That is right.

Q. Now, during the year 1937, when you were receiver for this company, I ask you, Mr. Ware, if you were able to make adequate provisions for meeting the debts and liabilities of the Artesian Water Company?

Mr. Tonjes: That is objected to, Your Honor, as calling for a conclusion.

The Member: I will overrule the objection.

The Witness: May I have the question?

(Whereupon, the reporter read the question as recorded.)

By Mr. Witter:

Q. As they matured? A. I was not.

Mr. Witter: That is all.

#### Cross Examination

By Mr. Tonjes:

Q. Mr. Ware, you stated that you were unable to meet or make arrangements for payment of debts as they matured. Which debts matured which could not be met?

A. The Pacific Mutual debts.

Q. Did you make arrangements with them to extend the time?

A. There was no definite arrangement as to extension. [63]

(Testimony of Mr. William E. Ware.)

Q. Did they take any legal proceedings against the corporation?

A. They started to take legal proceedings and then due to their own difficulties on some of their own matters they deferred the action with a more or less of a reservation that practically all of the income of this company would be diverted to them.

Q. Did the company become involved in any legal proceedings on account of its inability to pay its bills? A. No.

Q. And to the best of your knowledge all of its bills were paid?

A. Except this one obligation that was past due.

Q. That obligation was somewhat past due?

A. Yes. This obligation was past due since 1934.

Q. Now, what efforts did you make to obtain funds to refinance the loan to the Pacific Mutual Company?

A. I approached the loaning officers of the California Bank, the Security First National Bank, and two or three other bankers in town with the idea of attempting to put a new loan on to take the Pacific Mutual out.

Q. And what was the outcome of those negotiations?

A. They all fell through due to the fact that none of the loaning officers felt that they could make a new loan signed by the receiver. The title companies, in [64] other words, would not issue title satisfactory to the loaning agency.

(Testimony of Mr. William E. Ware.)

Q. It was more on account of a lack of ability to give good collateral in that they couldn't pass good title rather than the value of the collateral, is that correct?

A. No, I wouldn't say that because the value was more or less unknown. I recall that in the negotiations with the Security Bank they spent considerable time in the appraising. They had some idea of the values of these properties. They felt that because of the fact the title company couldn't be brought down that they wouldn't go any further with it. But I don't know the exact figures that they used in connection with their investigation.

Q. But the company did produce sufficient oil to have paid to them in the year 1937 royalties in the amount of \$175,000, is that correct?

A. Whatever the tax return shows. I don't have the information in front of me.

Mr. Witter: Do you mean gross royalties received, Mr. Tonjes?

Mr. Tonjes: Yes.

Q. I will amend my statement. I will change that figure to royalties in the amount of \$163,139.56. Would you say that that is correct? A. Yes.

[65]

Q. And the company also had some other items which produced income, did it not? A. It did.

Q. And that was in the form of rents?

A. Some rents, some interest.

(Testimony of Mr. William E. Ware.)

Q. And what was the nature of the property which produced the rents?

A. Some houses on Home Villa tract principally, and there were also some rentals from farming leases on the vacant acreage, and some rental from the Asphalt Paving Company which had a portion of the property on the Sentous property.

Q. Did the income from such properties during 1937 amount to \$8,353.86?

Mr. Witter: Is that gross income, Mr. Tonjes?

The Witness: Yes. That is the gross income from rentals.

By Mr. Tonjes:

Q. Do you know whether or not the property producing these rentals was incumbent?

A. Some of it was and some of it was not. The portion that produced the major portion of that revenue was incumbent.

Q. Can you show me on the balance sheet of the corporation wherein the incumbrances against such properties [66] are recorded?

A. They are under the item of Bonds, Notes, Mortgages Payable, Item 12 on the balance sheet.

Q. Does that include the indebtedness to the Pacific Mutual Company? A. It does.

Q. How much of it relates to the Pacific Mutual Company's indebtedness and how much to others, if you know?

A. At the end of 1937 the only indebtedness was due to the Pacific Mutual Life Insurance Com-

(Testimony of Mr. William E. Ware.)  
pany. There was no other indebtedness on mort-  
gage loans.

Q. Then the Pacific Mutual Company was a creditor and held license on both the oil property and the other properties of the Artesian Water Company, is that correct? A. That is correct.

Q. The corporation carries on its balance sheet an item Land and Buildings carried at a figure of somewhat in excess of one million dollars at the beginning of the taxable year, and \$999,000 at the close of the taxable year. Did you know the circumstances under which the properties in question were valued?

A. Yes. Most of the values appearing on the books are based upon the March 1, 1913 values of the properties of the company.

Q. Would you say that that March 1, 1913 value and [67] the value in 1937 were substantially different?

A. Well, I am not a real estate man and I cannot appraise values. I wouldn't know. I would say there would be a substantial difference based upon sales that were actually made.

Q. Would you say the value was greater in 1937 than in 1913, or less?

A. The value in 1937 would be less than in 1913.

Q. Would be less? A. Yes.

Q. And on what do you base such an opinion?

A. Largely upon the sales of property that were

(Testimony of Mr. William E. Ware.)  
made in the subsequent years showing losses over  
the values of 1913.

Q. Now, when the Pacific Mutual Company advanced money to the Artesian Water Company did the Artesian Water Company assign to the Pacific Mutual Company the Shell Oil lease?

A. It did.

Q. And under the terms of that lease, or under the terms of that loan rather, did the Shell Oil Company continue to pay all of the royalties to the Artesian Water Company? A. It did.

Q. And that was true during the entire year 1937? [68] A. That is right.

Q. Now the Artesian Water Company you say became involved in a receivership proceeding. Was that in the year 1934? A. 1935.

Q. Will you explain to the Board the circumstances of that receivership proceeding?

A. That receivership arose out of an action by one J. Baldwin against Frederick Ringe who was a stockholder of the Artesian Water Company. It appeared that Baldwin had a judgment of some \$200,000 against Frederick Ringe. After considerable investigation they located a safe deposit box in Stockton, California, and in this box there were some stock of the Artesian Water Company, some of the Marblehead Land Company, and some of the Ringe Company. The stock was acquired by Baldwin under sheriff's sale and application was made to these corporations to have the stock trans-

(Testimony of Mr. William E. Ware.)  
ferred to Baldwin. The corporate officers refused to transfer the certificates and counsel for Baldwin petitioned the Superior Court of this county for the appointment of a receiver *ex parte*, on the grounds that the corporate officers were not functioning under the code.

Under that action the Court appointed me as receiver.

Q. And in that connection was the question of in- [69] solvency or was the insolvency of the Artesian Water Company in any way involved?

A. I believe one of the grounds in the application for the receiver alleged fraud and conspiracy and mismanagement on the part of the corporation.

Q. This was not an action brought by a creditor against the corporation?

A. No, it was not. It was a stockholder presumably.

Q. When were you appointed receiver?

A. July 16, 1935.

Q. And when did you terminate your receivership? A. February 8, 1939.

Q. Now, what efforts were made in the meantime to have the receivership terminated by the stockholders?

A. At the original appointment an appeal was filed on the appointment of the receiver. An amended complaint was filed I believe in October of 1936, if my memory serves me. And in the amended complaint an allegation was set up I believe. There was

(Testimony of Mr. William E. Ware.)

a deadlock on the board. I was discharged under the original appointment and reappointed under the amended complaint.

Q. Then as I get it, neither the appointment of the receiver nor the continuation of the receivership was brought about by reason of the inability of the company to pay its bills, is that correct? [70]

A. Not brought about by that, no. But because of the negotiations that were going on with the Pacific Mutual Life Insurance Company for the extension of this loan, there was a more or less of a desire on the part of the corporation itself to permit the receiver to continue because they themselves in taking part would have been faced with the immediate calling of that loan and the assignment of all the income; while as long as the receiver was in and in control of the property the Pacific Mutual Life Insurance Company felt that whatever funds were coming to the company would be paid to them on their loan; and they virtually made the statement to one of the directors at one time that if the receivership were discontinued they would expect to immediately start action.

Mr. Tonjes: I think that is all.

#### Redirect Examination

By Mr. Witter:

Q. Mr. Tonjes has called to your attention certain rental income received by the company. I ask you to look at a copy of the income tax return and

(Testimony of Mr. William E. Ware.)  
state any deductions that are taken on that return  
that would apply against that rental gross income.

A. Well, there is \$4518.05 for the repairs and  
some depreciation.

Q. How much depreciation? [71]

A. \$3352.92 out of \$3425.92.

Q. And is there a tax deduction for taxes, State  
and County taxes? A. There is.

Q. How much is that?

A. Well, the total tax deduction is \$26,533.70.

Q. Would a portion of that apply to the rental  
properties? A. It would.

Q. Mr. Ware, you testified about your efforts  
to get finances with which to meet the demands of  
the Pacific Mutual Company. Were your efforts  
hampered and embarrassed by the fact that the  
notes were already over two years in default?

A. Oh, yes, that objection was brought up con-  
tinually.

Q. Were they hampered also by the fact that the  
company was in receivership? A. Yes.

Q. What steps, if any, did you take—I will  
withdraw that question.

As an auditor, are you quite familiar with tax  
procedure? A. Fairly so.

Q. Income tax procedure, Mr. Ware?

A. Yes. [72]

Q. As a receiver of this company, and in view  
of your familiarity and experience with income tax  
matters, what steps or precautions did you take,

(Testimony of Mr. William E. Ware.)

if any, to ascertain whether or not there would be any imposition of an undistributed profits tax in this case.

Mr. Tonjes: That is immaterial, Your Honor. I object to it.

The Member: What do you expect to show, Mr. Witter?

Mr. Witter: I really think it is immaterial, if Your Honor please.

The Member: I will sustain the objection.

Mr. Witter: That is all for the petitioner.

Mr. Tonjes: That is all, Mr. Ware.

The Member: Very well, you are excused.

Witness excused.

---

The Member: Do you gentlemen wish to submit this case on brief?

Mr. Witter: I would prefer to, Your Honor, I would like to submit a short brief.

The Member: Is that all of your evidence?

Mr. Witter: I think it might be helpful to introduce the return for the year 1937.

Mr. Tonjes: I think it might be, Your Honor.

Mr. Witter: There are some details shown in the [73] return that aren't reflected in that data.

The Member: It will be received as Petitioner's Exhibit No. 9.

(The said document so offered and received in evidence, was marked Petitioner's Exhibit 9, and made a part of this record.)







## Schedule C

## ANALYSIS OF PAID-IN OR CAPITAL SURPLUS

Page 3

1.	Debits to paid-in or capital surplus during the taxable year (to be detailed):	
	*	*
2.	Paid-in or capital surplus as shown by balance sheet at close of the taxable year (Schedule N)	\$371,872.13
3.	Total.....	\$371,872.13
4.	Paid-in or capital surplus as shown by balance sheet at close of the preceding taxable year (Schedule N) .....	\$371,872.13
5.	Credits during the year (to be detailed):	
	*	*
6.	Total.....	\$371,872.13

## Schedule D-1

## COST OF GOODS SOLD

(Where inventories are an income-determining factor)

[Not filled in]

## Schedule D-2

## COST OF OPERATIONS

(Where inventories are not an income-determining factor)

1.	Salaries and wages.....	\$
2.	Other costs (to be detailed):	
	(a) Cost of realized land sales.....	\$ 279.86
	*	*
3.	Total (enter as item 5, Schedule A).....	\$ 279.86

## Schedule E

## CAPITAL GAINS AND LOSSES

(From Sales or Exchanges Only)

[Not filled in]

## Schedule M

DISTRIBUTIONS TO STOCKHOLDERS AND  
DIVIDENDS PAID CREDIT

(See Instruction III)

[Not filled in]

[98]

**AMERICAN BANK COMPANY  
Subsidiary of American Security Bank Corporation**

	Statement of Financial Condition		Date of Financial Statement
	Assets	Liabilities	
<b>ASSETS</b>			
1. Cash:			
a. Demand deposits	\$ 16,160.00		\$ 21,962.17
b. Other bank deposits	1,248.10		16,616.42
c. Accounts receivable	21,644.10		12,345.42
d. Total reserves for local debts	21,844.10		16,616.42
4. Investments:			
a. Investments in Government obligations:			
(i) Obligations of the State, Territory, or political subdivisions thereof, or of the District of Columbia, or of United States instrumentalities			
(ii) Obligations of the United States			
(iii) Obligations of intergovernmental of the United States			
b. Other investments:			
(i) Bonds of domestic corporations			
(ii) Bonds of foreign corporations			
(iii) Bonds and stocks of foreign corporations			
(iv) Trust funds held by corporation			
(v) All other investments of banks			
7. Deferred charges:			
a. Periodic insurance, taxes, etc.			
b. Capital lease			
c. Buildings			
d. Machinery and equipment			
e. Furniture and fixtures			
f. Delivery equipment			
g. Other depreciation assets			
h. Total of items (a) to (f)	701.58		758.23
i. Less provide for depreciation			
j. Depreciable assets			
k. Less provide for depreciation			
l. Land			
m. Other assets (details below):			
(i) Bank rights	1,000.00		1,000.00
(ii) Land sales contracts	94,157.19		91,308.55
10. Total Assets	\$ 1,166,898.13		\$ 92,308.55
<b>LIABILITIES AND CAPITAL</b>			
11. Amounts payable:			
a. Deposits, notes, and overdrafts payable (with original maturity of more than 1 year):			
b. Notes, notes, and overdrafts payable (with original maturity of 1 year or more):			
c. Accrued expenses (details below):			
d. Taxes			
e. All other liabilities (including notes):			
12. Bank, notes, and overdrafts payable (with original maturity of less than 1 year):			
13. Notes, notes, and overdrafts payable (with original maturity of 1 year or more):			
14. Accrued expenses (details below):			
a. Interest	1,505.16		940.61
b. Taxes	9,388.28		13,526.44
c. Accrued expenses	11,493.44		14,467.95
15. Other liabilities (including notes):			
a. Contract deposits:			
(i) On 1958 profit on land sales	29,358.13		28,508.43
(ii) Contract deposits	259.00		490.00
16. Surplus reserves (details below):			
a. Preferred stock			
(i) Common stock			
(ii) Preferred and undivided profits			
b. Total Liabilities and Capital			
17. Capital stock:			
a. Preferred stock			
(i) Common stock			
(ii) Preferred and undivided profits			
b. Total Liabilities and Capital			
18. Total Liabilities and Capital	\$ 612,260.00		\$ 612,260.00
19. Surplus reserves (details below):			
a. Preferred stock			
(i) Common stock			
(ii) Preferred and undivided profits			
b. Total Surplus Reserves			
20. Total Liabilities and Capital Stock	\$ 1,166,898.13		\$ 1,166,898.13
<b>Schedule D—CHANGES IN CORPORATION'S OBLIGATIONS AND CAPITAL STOCK (See Instruction O)</b>			
	Obligations	Preferred Stock	Common Stock

1. Total cash received during taxable year from sale of corporation's own interest-bearing obligations with original maturity of 1 year or more and capital stock.

2. Total cash expended during taxable year for purchase or retirement of corporation's own interest-bearing obligations with original maturity of 1 year or more and capital stock.

3. Differences between 1 and 2.

\* Preferred stock for this purpose should be considered as stock which is preferred on the basis of dividends or worth, irrespective of formal designation.

2-2

## Schedule M

DISTRIBUTIONS TO STOCKHOLDERS AND  
DIVIDENDS PAID CREDIT

(See Instruction III)

[Not filled in]

[98]

# 1937 RETURN OF PERSONAL HOLDING COMPANY 1937

UNITED STATES

(Circular Stamp)

Treasury Department (Form 11800)

Internal Revenue Service

For Calendar Year 1937 or Fiscal Year

beginning \_\_\_\_\_, 1937, and ending \_\_\_\_\_, 1938

PARTY NAMES, COMBINATION OF NAME AND ADDRESS

William E. White, Receiver for Artesian Water Co.,

Oklahoma

721 West Seventh Street - Room 518

(Name and Address)

Los Angeles

(Name and Address)

California

(Name and Address)

Cash \_\_\_\_\_

Check \_\_\_\_\_

Bank \_\_\_\_\_

Post Payment \_\_\_\_\_

REVIEWED

SECTION 8

J. M. Kelly

DATE JULY 2, 1938

DATE JULY 2, 1938

## ADJUSTED NET INCOME COMPUTATION UNDER TITLE IA (See Instruction D)

1. Net income (or deficit) in Title I of the Revenue Act of 1936, as amended by the Revenue Act of 1937	\$ ..... 54,101.24
2. Add: Contributions or gifts deducted in computing item 1 (see item 5 below)	\$ ..... 54,101.24
3. Less: Expenses and depreciation over income from property not allowable under section 56 (b) (from Schedule A)	\$ ..... 54,101.24
4. Total of items 2 to 3	\$ ..... 54,101.24
5. Less: Contributions or gifts (from Schedule B) (not to exceed 15% of item 4)	\$ ..... 5,027.33
6. Federal income, war profits, and excess-profits taxes (from Schedule C)	\$ ..... 5,027.33
7. Income and profits taxes of a foreign country or United States possessions (not deducted in computing item 1)	\$ ..... 5,027.33
8. Amount paid in liquidation of liability of the corporation based on liability of a decedent to make contributions or gifts (attach statement, see Instruction B)	\$ ..... 5,027.33
9. Total of items 5 to 8	\$ ..... 5,027.33
10. Adjusted net income (item 9 minus item 9)	\$ ..... 49,071.61
11. Adjusted net income (item 10 above)	\$ ..... 49,071.61
12. Less: Dividends paid credit	\$ ..... 53,000.00
13. Amount (and if erroneously set aside to pay or retire indebtedness of any kind incurred prior to January 1, 1938) (from Schedule D, line 12)	\$ ..... 53,000.00
14. Total of items 12 and 13	\$ ..... 53,000.00
15. Undeducted adjusted net income (item 11 minus item 14)	\$ ..... 53,000.20
COMPUTATION OF TAX	
16. Surtax on portion of item 15, not in excess of \$2,000, at 65%	\$ ..... 0
17. Surtax on amount of item 15, in excess of \$2,000, at 75%	\$ ..... 0
18. Total surtax in items 16 and 17	\$ ..... 0

Provide below the names and addresses of the individuals who owned, directly or indirectly, at any time during the last half of the taxable year, more than 50 percent in value of the outstanding capital stock of the corporation.

Name	Address	Number of shares owned during last half of taxable year
Patricia	Common	
Samuel E. White	Artesian Water Company, Oklahoma City, Oklahoma	1,523
Samuel E. White	Artesian Water Company, Los Angeles, California	1,272
Samuel E. White	Artesian Water Company, Los Angeles, California	816

## WITNESS FOR (See Instruction F)

William E. White, Receiver

The undersigned, president, vice-president, treasurer, manager, or other principal officer, and manager for whom he acts, and his wife, dependents and next of kin, do solemnly declare and say that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Acts of 1936 and 1937 and the Regulations issued thereunder.

Subscribed and sworn to before me this day of July, 1938.

William E. White, Receiver, f/c.

(Signature)

(Name)

CORPORATE SEAL

(Name of corporation, if any)

(Address of corporation, if any)

CORPORATE SEAL

If this return was prepared by some person or persons other than officers or employees of the corporation, the following affidavit must be submitted:

I, the owner (or officer) that I've prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the net tax liability by section 35 of the Revenue Act of 1936, as amended by the Revenue Act of 1937, of the person for whom this return has been prepared of which I have any knowledge.

Subscribed and sworn to before me this day of July, 1938.



NOTE—One form marked "DUPLICATE COPY" must be filed with this original return (do not file a duplicate copy in two places). P-1000

A-10



Artestian Water Company  
Income Tax Return—Year 1937

Statement re: Exemption Claimed on Undistributed Profits Surtax:

Exemption from undistributed profits surtax is claimed on the following grounds. Attention is respectfully directed to Section 14 of the Revenue Act of 1936, part (d) (2) of which reads:

“(d) Exempt from surtax. The following corporations shall not be subject to the surtax imposed by this Section:

“(2) Domestic corporations which for any portion of the taxable year are in bankruptcy under the laws of the United States, or are insolvent and in receivership in any Court of the United States, or of any State, Territory or the District of Columbia.”

The word “insolvent” was apparently used in its dual sense by Congress. The Senate Finance Committee Report on the Revenue Bill of 1936 of June 1, 1936, on page 15, in discussing Section 14 (d) (2), said:

“The Finance Committee Bill also avoids the possibility of tax avoidance by collusive receiverships by limiting the provision to cases in which the corporation is in bankruptcy under the Federal bankruptcy laws, and to cases in which it is insolvent, i.e., its liabilities are in excess of its assets or it is unable to pay the

claims of creditors as they mature—and in receivership in Federal or State Courts."

The taxpayer was certainly unable to pay the claims of its creditors as they matured. That is, it was unable to pay them in the usual course of business out of quick assets without selling its capital assets. 32 Corpus Juris 806 states that the word "insolvency" has two meanings:

"In its general and popular meaning, the term denotes the state of one whose entire property and assets, when converted into money without unreasonable haste or sacrifice, are insufficient to pay his debts; \* \* \* But it is frequently used in the more restricted sense to express the inability of a person to pay his debts as they become due in the ordinary course of business."

Creditors claims, referred to above, which the corporation was unable to pay at maturity, consist of balance due the Pacific Mutual Life Insurance Company on account of money borrowed on November 12, 1929, and represented by two notes, one for \$35,000 and one for \$175,000. The note for \$35,000 carried with it a specific agreement prohibiting the payment of dividends until said note was paid. During 1936 the sum of \$26,750 was paid on this note leaving a balance of \$8,250 which balance was paid during 1937, whereupon the note and collateral agreement were cancelled.

Similarly, during 1937 payments totaling \$74,750 were made on the note for \$175,000, making a grand total of payments made of \$83,000.

The corporation owns subdivision land and oil producing property. The oil land is under lease to Shell Oil Company. The corporation secured its note to the Pacific Mutual Life Insurance Company by a mortgage on its properties, and gave as collateral security an assignment of the oil lease "together with all rents due, or to become due thereunder". The mortgagee notified Shell Oil Co. of the pledge of the lease and rents and instructed Shell Oil Co. to continue to pay the rents and royalties due under the lease to the corporation until further notice. The note and mortgage became due November 30, 1934, and is still past due. It has not been extended or renewed, and will outlaw November 30, 1938. [101]

The corporation has never been in a position to pay off the mortgage out of current assets. From the foregoing, it is apparent, therefore, the corporation was insolvent and in receivership during the taxable year 1937, and is exempt from the surtax under Section 14. [102]

Artesian Water Company  
Year 1937

Supplemental Schedule—Item 19—Bad Debts:

Item of \$14,160.00 represents note in principal amount of \$12,000.00 plus interest accrued thereon to December 31, 1935, said interest having been re-

ported as income in 1933, 1934 and 1935, in the sum of \$2,160.00 and was written off in 1937 as a bad debt. The following quotation is from letter of Meserve, Mumper, Hughes & Robertson, attorneys representing the receiver, relative to said note:

“During the year 1937 we instituted the above entitled action for the purpose of collecting that certain promissory note dated December 13, 1934, in the amount of \$12,000 with interest from January 1, 1932, until paid, at the rate of 6% per annum, payable semi-annually, in favor of Artesian Water Co. and signed by Maclay Rancho Water Co. by M. K. Ridge, President and P. D. Gowen, Secretary. We have been unable to effect any collection whatsoever on account of the judgment obtained in the above action. In fact, we have not even been able to recover costs expended in recovering the judgment. In our opinion, the judgment is, and at all times has been, valueless, and you are entitled to write off the note sued on as a loss for the year 1937.”

A statement of the financial condition as of September 30, 1937 of the Maclay Rancho Water Co., prepared by its bookkeeper, disclosed the fact that, in the event of disposition at fair market values of its assets, it would not be possible to realize a sum sufficient to pay off the company's bonded indebtedness. [103]





## Schedule A

EXCESS OF EXPENSES AND DEPRECIATION OVER  
INCOME FROM PROPERTY NOT DEDUCTIBLE  
UNDER SECTION 356

[Not filled in]

## Schedule B

## CONTRIBUTIONS OR GIFTS

[Not filled in]

## Schedule C

FEDERAL INCOME, WAR-PROFITS, AND  
EXCESS-PROFITS TAXES

Nature of Tax	Taxable Year	Amount
Federal Income Tax—Normal.....	1936	\$4,145.91
Federal Excess Profits.....	1936	617.82
Federal Surtax on Und. Profits.....	1936	263.60
Total (enter as item 6, first page).....		\$5,027.33

## Schedule D

AMOUNTS USED OR SET ASIDE TO PAY OR RETIRE  
INDEBTEDNESS INCURRED PRIOR TO JANUARY  
1, 1934

I

1. Description of indebtedness..... Mortgage Note
2. Date incurred or assumed..... November 12, 1929
3. Date due ..... November 30, 1934
4. Original amount of indebtedness..... \$210,000.00
5. Amount used or set aside prior to January 1,  
1934, to pay or retire such indebtedness.....
6. Excess of indebtedness on January 1, 1934, over  
total amount used or set aside prior to that  
date to pay or retire such indebtedness..... \$210,000.00

7. Amounts used or set aside to retire such indebtedness during the following calendar years, or during fiscal years beginning in such calendar years	1934 \$..... 1935..... 1936..... 26,750.00
8. Amount used or irrevocably set aside during the taxable year covered by this return to pay or retire such indebtedness.....	83,000.00
9. Total of lines 7 and 8.....	\$109,750.00
10. Balance of indebtedness (line 6 minus line 9).....	\$100,250.00
11. Indicate separately:	
(a) Amount actually used during the taxable year covered by this return to pay or retire the indebtedness.....	\$ 83,000.00
(b) Amount irrevocably set aside during the taxable year covered by this return to pay or retire the indebtedness, but not actually used during the taxable year for such purpose .....	\$.....
12. Portions of amounts entered on line 8 above, claimed as deductions for the taxable year covered by this return (enter total as item 13, first page) .....	\$ 83,000.00

Indicate by check mark whether the deduction claimed in item 13, first page of this return, represents:

- A  Amount actually used during the taxable year to pay or retire the indebtedness;
- B  Amount irrevocably set aside during the taxable year to pay or retire the indebtedness; or
- C  Combination of both A and B.

There must be furnished all of the facts and circumstances upon which the taxpayer relies to establish the reasonableness of the amount claimed as a deduction. Describe fully

the plan for payment or retirement of the obligations, indicating date and method of adoption, and where the plan is covered by a mandatory sinking fund agreement or similar arrangement, submit a copy of the indenture or agreement by which the fund was established and under which it is maintained—See attached statement.

If the amount claimed as a deduction in item 13, first page of this return, represents an amount irrevocably set aside to pay or retire the indebtedness, explain fully the circumstances and method by which it was irrevocably set aside.

[105]

Artesian Water Company  
Personal Holding Company Return  
Year 1937

Statement re: Item 13 (from Schedule D)  
Amounts Used to Pay Indebtedness Incurred Prior  
to January 1, 1934:

The indebtedness consists of note secured by mortgage given to Pacific Mutual Life Insurance Co. The note and mortgage became due November 30, 1934 and is still past due. It has not been extended or renewed and will outlaw November 30, 1938. The mortgage includes oil land under lease to Shell Oil Company and other acreage and is further secured by the assignment of existing leases which constitute the corporation's chief source of income. The mortgagee notified Shell Oil Co. of the pledge of the lease and rents, and instructed the Shell Oil Co. to continue to pay the rents and royalties due under the lease to the corporation until further notice.

As a result of numerous discussions with the mortgagee relative to the payment of the indebtedness the receiver tendered to the mortgagee and the mortgagee accepted payments of \$2,750 per month on the principal, in addition thereto sums totaling \$50,000.00 were paid and accepted during 1937. This procedure followed an expressed intention of the mortgagee to collect from the lessee the royalties from the oil lease, or to foreclose. The payments on principal during 1937 totaled \$83,000.00, and same were made with the approval and by authorization of the Superior Court of the State of California, which has jurisdiction over the corporation's receivership.

The mortgagee has formally refused to extend or renew the mortgage. At the present time the indebtedness is past due and subject to possible action by the mortgagee. The mortgage cannot be refinanced while the corporation is in receivership, as no one will take a note or mortgage signed by the receiver.

The payment of \$83,000.00 in 1937 was reasonable, considering the size and terms of the mortgage, and considering also that the oil royalties were pledged to the mortgagee, and that the pledgee was entitled to take the royalties to apply on interest and principal (Section 2989 of the California Civil Code, 21 Cal. Jur. 312, 14 C. J. 822). Consideration should also be given to the fact that the corporation was in receivership and the court authorized these payments. [106]

**1937 RETURN OF CAPITAL-STOCK TAX**  
**For Year Ending June 30, 1937****Domestic Corporations**

(Sec. 105, Revenue Act of 1935, as amended by Sec. 401 of the Revenue Act of 1936)

This return must be filed, in triplicate, and received by the Collector of Internal Revenue for your district on or before July 31, 1937. The tax must be paid on or before that date.

1. Name—William E. Ware, Receiver for Artesian Water Company.
2. Address—727 West Seventh Street, Los Angeles, California.
3. Name of parent company, if any.....  
(District filed .....
4. Name of subsidiary, if any.....  
No. shares held..... (District filed .....
5. Nature of business in detail—Land Owners.
6. Incorporated or organized in State of California. Month April Day 23rd Year 1900.
7. Was a capital-stock tax return filed for the preceding taxable year ended June 30, 1936? Yes. If filed under a different name, state the name.....  
(District filed .....
8. Date of close of last income-tax taxable year ended on or prior to June 30, 1937, or, if newly organized corporation having no income-tax taxable year ended on or prior to June 30, 1937, date of organization.....

Corporation making an original declaration of value upon this return must enter the amount of such declared value in item 9. This block is not to be used by a corporation which established its original declared value by the first return for the year ended June 30, 1936.

9. Original declared value of entire capital stock.....\$.....

(The value declared must be definite and unqualified. A value must be declared in every case regardless of whether exemption from the tax is claimed. See instructions 1 and 3)

Corporations which have established their original declared value by the return for the year ended June 30, 1936, must adjust such declared value as provided for in Schedule I on page 2 of this return and then after the amount of the adjusted declared value in item 10.

10. Adjusted declared value of entire capital stock (Last item of Schedule I, page 2)...\$310,944.44

11. Exemptions.—The Act provides for an exemption from the tax only on the grounds indicated below. Corporations claiming exemption must (1) report a value for the capital stock under item 9 or 10, (2) check the appropriate block below, showing the basis of the claim, and (3) submit with the return a full statement of the evidence specified under the block checked.

Corporation exempt from income tax under section 101, Revenue Act of 1936. (1) State under which subsection of section 101 ..... (2) Furnish information required by instruction 14.

Insurance company subject to tax under section 201, 204, or 207, Revenue Act of 1936. State which section.....

Corporation not doing business. (1) Furnish information required by instruction 16. (2) Report value of capital stock in item 9 or 10 above.

Computation of Tax	For Use of Taxpayer	For Use of Department
12. Amount reported in item 9 or 10.....	\$310,944.44	\$.....
13. Tax at rate of \$1 for each full \$1,000 in item 12 (omit cents).....	Exempt	xxxx
14. Penalty of ..... percent for delinquency in filing return .....		
15. Interest at 6% per annum beginning August 1, 1937 .....		
16. Total tax, penalty, and interest.....		

I, the undersigned William E. Ware, Receiver for Artesian Water Co. and ....., of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including any accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1935, as amended, and the Regulations issued thereunder.

Sworn to and subscribed before me this.....day  
of ....., 193.....

[Corporate  
Seal]

WILLIAM E. WARE

Receiver

[Notarial  
Seal]

[Exemption allowed. Jan. 8, 1938. JMB]

[107]

Page 4

The schedules on this page must be filled in by every corporation making adjustments to an original declared value for the capital stock established by the return for the year ended June 30, 1936. See instructions 5 to 9, inclusive.

**SCHEDULE I. ADJUSTMENT OF ORIGINAL DECLARED VALUE  
OF ENTIRE CAPITAL STOCK FOR ALL TRANSACTIONS DUR-  
ING THE INCOME-TAX TAXABLE YEAR ENDED DECEMBER  
31, 1936.**

Original declared value as established by the first return for  
the taxable year ended June 30, 1936.....\$250,000.00

Additions:

(1) (a) Total cash paid in for stock or shares (see instruction 7, item 1).....\$	—
(b) Fair market value of all property received for stock or shares (see instruction 7, item 1).....	—
(2) Paid-in surplus and contributions to capital (see instruction 7, item 2).....	—
(3) Net income (see instruction 7, item 3)	34,679.23
(4) Excess of income wholly exempt from tax over amount disallowed as deduc- tions by section 24 (a) (5) of the Rev- enue Act of 1934 or 1936 (see instruc- tion 7, item 4).....	26,265.21

(5) Dividend deduction allowable for income-tax purposes (see instruction 7, item 5) .....	—
Total additions .....	<u>60,944.44</u>
Total Before Deductions.....	\$.....
<b>Deductions:</b>	
(A) (1) Total cash distributed in liquidation to shareholders (see instruction 7, item A) .....	\$ —
(2) Fair market value of all property distributed in liquidation to shareholders (see instruction 7, item A) .....	—
(B) Distributions of earnings or profits (see instruction 7, item B).....	—
(C) Excess of deductions allowable over gross income and claimed on income-tax return (see instruction 7, item C).....	—
Total deductions .....	<u>—</u>
Adjusted Declared Value (enter in item 10, page 1).....	<u>\$310,944.44</u>

## SCHEDULE II. ANALYSIS OF CHANGES IN CAPITAL STOCK AND SURPLUS

### Capital Stock and Surplus at beginning of year

1. Capital stock: Preferred.....	.....
Common.....	\$612,220.00
2. Capital or paid-in surplus.....	.....
3. Surplus reserves.....	.....
4. Surplus and undivided profits.....	264,431.87

### Additions—Capital transactions

5. Total cash and fair market value of property paid in for stock or shares (total of items 1(a) and 1(b), Schedule I)*.....	.....
--	-------

6. Paid-in surplus and contributions to capital  
(item 2, Schedule I)\*.....

7. Other additions (to be detailed).....

Additions—Revenue transactions

8. Net income (item 3, Schedule I)..... \$34,679.23

9. Income wholly exempt from income tax.  
(This total less the amount entered as item  
17 of this schedule should correspond with  
item 4, Schedule I) (See instruction 7, item  
4) .....

26,265.21

10. The amount of the dividend deduction allowable  
for income-tax purposes (item 5, Schedule I) (see instruction 7, item 5).....

11. Other additions (to be detailed).....

Sign space rental (1934-5)..... \$146.63

1936 Excess Profits tax..... 617.82

Total..... \$938,360.76

Deductions—Capital transactions

12. Liquidating distributions (total of items A(1)  
and A(2), Schedule I)\*.....

13. Other distributions (item B, Schedule I)\*.....

14. Enter class and amount of distributions in  
corporation's own stock:  
..... \$..... x x x x x

15. Other deductions (to be detailed).....

Deductions—Revenue transactions

16. Excess of deductions allowable over gross  
income and claimed on income-tax return  
(item C, Schedule I).....

17. Deductions disallowed by sec. 24(a)(5), 1934  
or 1936 Act. (See item 9 of this schedule).....

18. Other deductions (to be detailed).....

Taxes paid (for prior yrs)..... \$4,149.34

Street bonds (for prior yrs)..... 76.74

1935 Income tax..... 614.52

## Capital Stock and Surplus at end of year

19. Capital stock: Preferred.....	.....
Common.....	612,220.00
20. Capital or paid-in surplus.....	.....
21. Surplus reserves .....	.....
22. Surplus and undivided profits.....	321,300.16
Total.....	\$938,360.76

\*Enter values shown by the books if different from values entered in Schedule I and explain difference.

[108]

Mr. Tonjes: With permission to withdraw the original and substitute a photostat.

The Member: Yes. Permission will be granted to substitute a photostat.

The Clerk: Let the record show that counsel for the respondent is withdrawing Petitioner's Exhibit No. 9, the income tax return, for the purpose of making a photostatic copy.

The Member: Do you desire that the time for the filing of briefs be fixed at forty-five days as provided by the rules, or do you wish a different time?

Mr. Witter: That time is satisfactory to me.

Mr. Tonjes: I believe that will be satisfactory.

If Your Honor please, I am wondering in view of the fact that Mr. Witter desires to point out some of the local law and its applicability, whether it might not be more helpful to have Mr. Witter file an opening brief and I will file a reply brief, giving

[Title of Board and Cause.]

CERTIFICATE

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 110, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeclipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 1st day of May, 1941.

[Seal]

B. D. GAMBLE,  
Clerk,

United States Board of Tax Appeals.

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[Endorsed]: No. 9824. United States Circuit Court of Appeals for the Ninth Circuit. Artesian Water Company, a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed May 16, 1941.

PAUL P. O'BRIEN,  
Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

In the United States Circuit Court of Appeals  
for the Ninth Circuit

U. S. C. C. A. No. 9824

Docket No. 100824

ARTESIAN WATER COMPANY, a corporation,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

To the Clerk of the Circuit Court of Appeals:

Petitioner hereby assigns the following errors  
and designates the entire record for printing:

**ASSIGNMENT OF ERRORS ON APPEAL**

(1) The Board erred in holding that the Petitioner was subject to surtax under Section 14 of the Revenue Act of 1936 for not distributing its profits in the year 1937.

(2) The Board erred in not finding as a fact, and holding as a matter of law, that the Petitioner was in receivership and insolvent during 1937, or a portion thereof, and, therefore, under the provisions of Section 14 (d)(2) of the Revenue Act of 1936, not subject to surtax imposed by Section 14 (b) of that Act.

(3) The Board erred in not finding as a fact, and holding as a matter of law, that the mortgages of Petitioner's income producing assets and the assignment of its leases, under the circumstances and commitments existing in the taxable year, did con-

stitute a contract restricting it from the payment of dividends within the meaning of Section 26 (c)(1) of the Revenue Act of 1936.

(4) The Board erred in not finding as a fact, and holding as a matter of law, that the mortgages of Petitioner's income producing assets and assignment of Petitioner's leases, under the circumstances and commitments existing in the taxable year, did constitute a requirement that the Petitioner pay on, or set aside for payment on, its indebtedness, its earnings and profits of the taxable year and, therefore, rendering it exempt from surtax under the specific provisions of Section 14 (c)(2) of the Revenue Act of 1936.

(5) The Board erred in holding that the Statutes of California prohibiting Petitioner from declaring a dividend while it was unable to pay its debts, did not constitute a contract exempting the Petitioner from surtax on undistributed profits under the provisions of Section 26 (c)(1) and (2) of the Revenue Act of 1936.

#### DESIGNATION OF PORTIONS OF THE RECORD

The Petitioner desires that the entire certified transcript be printed for the record on appeal.

GEORGE G. WITTER

453 So. Spring Street

Los Angeles, California

Attorney for Petitioner

[Endorsed]: Filed May 21, 1941. Paul P.  
O'Brien, Clerk.